Supreme Court, U.S.
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No. OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1996

MOHAMMAD SAMIH BARAKAT,

Petitioner,

v.

THE LIFE INSURANCE COMPANY OF VIRGINIA,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Petitioner filed a reorganization plan under Chapter 11 of the Bankruptcy Code which classified the unsecured mortgage deficiency claim of a non-recourse undersecured creditor separately from other unsecured non-priority claims.

The questions presented are:

1. Is an unsecured mortgage deficiency claim which arises solely by virtue of 11 U.S.C. § 1111(b) "substantially similar" to general unsecured claims, thereby allowing such a claim to be classified with general unsecured claims pursuant to 11 U.S.C. § 1122(a)?

2. If the answer to the foregoing question is "yes," is there an implicit requirement in 11 U.S.C. § 1122 (or elsewhere in the Bankruptcy Code) that all "substantially similar" claims *must* be classified together absent some business justification independent of satisfying the "one consenting impaired class" requirement of 11 U.S.C. § 1129(a)(10)?

3. If the answer to the foregoing question is "yes," does such "business justification" exist whenever the factors identified in *In re Baldwin Park Towne Center, Ltd.*, 171 B.R. 374, 377 (Bankr. C.D. Cal. 1994) are present? If not, what can possibly constitute such "business justification"?

LIST OF PARTIES

The parties to the proceeding in the Court whose judgment is sought to be reviewed are Petitioner MOHAMMAD SAMIH BARAKAT, an individual, and Respondent THE LIFE INSURANCE COMPANY OF VIRGINIA. Petitioner does not know whether there are any parent companies or nonwholly owned subsidiaries of Respondent.

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PETITION FOR WRIT OF CERTIORARI

Petitioner MOHAMMAD SAMIH BARAKAT ("Barakat") respectfully prays that a writ of certiorari issue to review the opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on November 12, 1996, in order to resolve the conflict between the Ninth Circuit and Seventh Circuit Courts of Appeals on the important questions presented herein.

OPINIONS AND ORDERS BELOW

1. Ninth Circuit Opinion Giving Rise to This Petition

The Opinion of the United States Court of Appeals for the Ninth Circuit ("Ninth Circuit") that gives rise to this petition was filed November 12, 1996 and is reported at 99 F.3d 1520 (9th Cir. 1996); said Opinion is reprinted in the Appendix hereto at page A-1.

2. Other Opinions and Orders

A. Ninth Circuit Orders

The unpublished Order of the Ninth Circuit granting Barakat's motion to stay the mandate filed December 30, 1996 is reprinted in the Appendix at page A-23. The unpublished Order of the Ninth Circuit denying Barakat's petition for rehearing filed December 19, 1996, is reprinted in the Appendix at page A-24. The unpublished Order of the Ninth Circuit releasing this matter from the settlement program filed October 12, 1995 is reprinted in the Appendix at page A-25. The unpublished Order of the Ninth Circuit setting an in-person settlement conference filed August 8, 1995 is reprinted in the Appendix at page

A-26. The unpublished Order of the Ninth Circuit postponing the assessment conference filed July 5, 1995 is reprinted in the Appendix at page A-28. The unpublished "Order Setting Assessment Conference" of the Ninth Circuit filed June 23, 1995 is reprinted in the Appendix at page A-29.

B. District Court Opinion and Orders

The unpublished "Order Granting Stay Pending Appeal" of the United States District Court for the Central District of California ("District Court") filed April 24, 1995 is reprinted in the Appendix at page A-32. The unpublished "Memorandum Opinion Affirming Bankruptcy Court's August 15, 1994 and August 16, 1994 Orders" of the District Court filed April 10, 1995 is reprinted in the Appendix at page A-36. The unpublished "Order re Transfer Pursuant to General Order 224 (Related Case)" of the District Court filed October 13, 1994 is reprinted in the Appendix at page A-54.

C. Bankruptcy Court Opinion and Orders

The unpublished "Order on Application for Payment of Interim Fees and/or Expenses (11 U.S.C. § 331)" of the United States Bankruptcy Court for the Central District of California ("Bankruptcy Court") filed July 14, 1995 is reprinted in the Appendix at Page A-57. The "Memorandum of Opinion on Motions for Conditional Approval of Disclosure Statement and for Relief from the Automatic Stay" of the Bankruptcy Court filed September 26, 1994 and published at 173 B.R. 672 (Bankr. C.D. Cal. 1994) is reprinted in the Appendix at page A-61. The unpublished "Order Granting Stay Pending Appeal" of the Bankruptcy

Court filed September 8, 1994 is reprinted in the Appendix at page A-83. The unpublished "Order Approving Application by Debtor-in-Possession to Employ Substitute General Bankruptcy Counsel Nunc Pro Tunc to April 14, 1994 (Mayer, Glassman & Gaines)" of the Bankruptcy Court filed August 31, 1994 is reprinted in the Appendix at page A-88. The unpublished "Order Denying Approval of Debtor's Second Amended Disclosure Statement" of the Bankruptcy Court filed August 11, 1994 is reprinted in the Appendix at page A-91. The unpublished "Order Granting Motion for Relief from the Automatic Stay Pursuant to 11 U.S.C. § 362" of the Bankruptcy Court filed August 9, 1994 is reprinted in the Appendix at page A-95. The unpublished "Order Granting Motion for Relief from the Automatic Stay Pursuant to 11 U.S.C. § 362" of the Bankruptcy Court filed January 11, 1994 is reprinted in the Appendix at page A-99. The unpublished "Proposed Order Approving Application to Employ Gary Kleinman as Counsel for Debtor" of the Bankruptcy Court filed November 18, 1993 is reprinted in the Appendix at page A-103.

JURISDICTION

The judgment sought to be reviewed was entered on November 12, 1996, by the United States Court of Appeals for the Ninth Circuit ("Ninth Circuit") (Appendix, page A-1). On December 19, 1996, the Ninth Circuit entered an Order denying Barakat's timely-filed petition for rehearing (Appendix, page A-24). On December 30, 1996, the Ninth Circuit entered an Order granting Barakat's motion to stay the mandate for 30 days from the

date of said order (*i.e.*, until January 29, 1997) (Appendix, page A-23).

Pursuant to Supreme Court Rule 13.1, this petition has been filed within ninety (90) days of the denial of rehearing. Further, this petition has been filed before expiration of the stay of the mandate issued by the Ninth Circuit.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION AND STATUTES INVOLVED

United States Constitution, Article I, Section 8 provides:

> "The Congress shall have Power . . . To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States. . . . "

Section 1111(b) of the Bankruptcy Code (11 U.S.C. § 1111(b)) provides:

> "(b)(1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless –
>
> (i) the class of which such claim is a part elects, by at least two-thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection; or
>
> (ii) such holder does not have such recourse and such property is sold under section 363 of this title or is to be sold under the plan.

(B) A class of claims may not elect application of paragraph (2) of this subsection if –

(i) the interest on account of such claims of the holders of such claims in such property is of inconsequential value; or

(ii) the holder of a claim of such class has recourse against the debtor on account of such claim and such property is sold under section 363 of this title or is to be sold under the plan.

(2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed."

Section 1122 of the Bankruptcy Code (11 U.S.C. § 1122) provides:

"(a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.

(b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience."

Section 1129(a)(10) of the Bankruptcy Code (11 U.S.C. § 1129(a)(10)) provides:

"(a) The court shall confirm a plan only if all of the following requirements are met:

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider."

STATEMENT OF THE CASE

In May 1989, Barakat and four relatives ("the Barakat Group") acquired title to an 85-unit three-story residential apartment building located at 14420 Kittridge Street, Van Nuys, California ("Kittridge").

The purchase price of Kittridge was $6,880,000, of which the Barakat Group paid $2,470,000 (35.88%) in cash (of this amount, Barakat paid $823,000). The balance of the purchase price ($4,410,000) was paid by assumption of the existing *non-recourse* first trust deed note ("the Note") payable to Respondent THE LIFE INSURANCE COMPANY OF VIRGINIA ("LICV"), with the consent of LICV.

For four years – from May 1989 until June 1993 – the Barakat Group was current on payments on the Note. As the recession dragged on into 1993, the vacancy rate at Kittridge increased, and Kittridge began operating at a loss. Real property values – especially for residential apartment buildings – plummeted throughout Southern California, making a sale or refinance of Kittridge impossible.

In June 1993, the Note went into default. On June 13, 1993, title to Kittridge was consolidated in Barakat by quitclaim deed from the other members of the Barakat Group.

After unsuccessful negotiations to restructure the Note, on October 22, 1993, Barakat filed a voluntary Chapter 11 case in the United States Bankruptcy Court, Central District of California (Case No. LA 93-47514-GM). LICV recorded a Notice of Default initiating nonjudicial foreclosure under California law on the same day.

On November 17, 1993, LICV filed a motion for relief from the automatic stay. On January 11, 1994, the Bankruptcy Court filed an order which modified the automatic

stay to allow LICV to foreclose judicially, and to proceed with nonjudicial foreclosure except for conducting an actual foreclosure sale of Kittridge (Appendix, page A-99).

On June 20, 1994, Barakat filed an amended disclosure statement and plan of reorganization. The plan provided for the reduction of LICV's secured claim to $3,970,000 (the fair market value of Kittridge), and the classification of LICV's $570,000 unsecured mortgage deficiency claim separately from 43 other unsecured nonpriority claims totalling $74,652. On August 2, 1994, Barakat filed a Second Amended Plan of Reorganization ("the Plan") and a Second Amended Disclosure Statement ("the Disclosure Statement") which made certain revisions to the prior plan not relevant here.

On August 9, 1994, two key hearings in this case were conducted in the Bankruptcy Court. First, the Bankruptcy Court considered approval of the Disclosure Statement. The central issue at the hearing on the Disclosure Statement was the separate classification of the unsecured mortgage deficiency claim of LICV. The Bankruptcy Court found that it was bound by the recent decision of the Ninth Circuit Bankruptcy Appellate Panel in *In re Tucson Self-Storage, Inc.*, 166 B.R. 892 (Bankr. 9th Cir. 1994), which held that it was impermissible, absent a business justification, to classify an unsecured mortgage deficiency claim separately from the general unsecured class. Accordingly, the Bankruptcy Court disapproved the Disclosure Statement. The Bankruptcy Court reached this result reluctantly, noting on the record that the Bankruptcy Court believed that *Tucson* was decided incorrectly, and that the recent contrary decision of the Seventh Circuit Court of Appeals in *Matter of Woodbrook*

Assocs., 19 F.3d 312 (7th Cir. 1994), was the correct determination of the separate classification issue.[1]

After disapproving the Disclosure Statement on the basis of the classification issue, the Bankruptcy Court then took up the continued hearing on LICV's motion for relief from automatic stay. Since it was undisputed that there was no equity in Kittridge, the first part of the two-prong test under 11 U.S.C. § 362(d)(2) ("debtor does not have an equity in such property") was clearly met. With regard to the second part of the § 362(d)(2) test, the Bankruptcy Court found that an effective reorganization was not in prospect, based upon the denial of approval of the Disclosure Statement. The Bankruptcy Court ordered the automatic stay terminated, with the proviso that LICV could not conduct a foreclosure sale before September 9, 1994, and that LICV could not seek appointment of a receiver absent further order.

On the basis of these rulings, the Bankruptcy Court filed an "Order Granting Motion for Relief from the Automatic Stay Pursuant to 11 U.S.C. § 362" on August 9, 1994 (Appendix, page A-95), and an "Order Denying Approval of Debtor's Second Amended Disclosure Statement" on August 11, 1994 (Appendix, page A-91). On September 26, 1994, the Bankruptcy Court filed a "Memorandum of Opinion on Motions for Conditional

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[1] At the District Court and Ninth Circuit levels, a significant issue on appeal was the stare decisis effect of Bankruptcy Appellate Panel decisions. This issue is not directly presented for review on certiorari by this Court because the Ninth Circuit, in ruling on the merits on the classification issue, expressly declined to decide the authoritative effect of Bankruptcy Appellate Panel decisions (Appendix, page A-16).

Approval of Disclosure Statement and for Relief from the Automatic Stay" (Appendix, page A-61).

Barakat timely appealed to the United States District Court for the Central District of California. On April 10, 1995, the District Court filed its "Memorandum of Opinion Affirming Bankruptcy Court's August 15, 1994 and August 16, 1994 Orders" (Appendix, page A-36).

Barakat timely appealed to the United States Court of Appeals for the Ninth Circuit. On November 12, 1996, the Ninth Circuit filed its Opinion affirming the District Court (Appendix, page A-1). On November 22, 1996, Barakat timely filed a petition for rehearing and suggestion for rehearing in banc. The petition for rehearing was denied by the Ninth Circuit on December 19, 1996 (Appendix, page A-24). On December 23, 1996, Barakat timely filed a motion to stay the mandate pending application for writ of certiorari. The Ninth Circuit granted said motion, and issued a stay of its mandate for 30 days on December 30, 1996 (Appendix, page A-23).

REASONS FOR GRANTING THE WRIT

I. The Ninth Circuit's Opinion Directly Conflicts with the Seventh Circuit Decision in *Woodbrook Assocs.* on the Same Important Matter.

The decision below is in direct and irreconcilable conflict with the Seventh Circuit's decision in *Matter of Woodbrook Assocs.*, 19 F.3d 312 (7th Cir. 1994). The Bankruptcy Court, District Court, and Ninth Circuit each acknowledged this conflict (Appendix, pages A-65-66, A-47, and A-11-16, respectively). The Bankruptcy Court termed the conflict one of "diametrically opposed opinions." (Appendix, page A-65).

Certiorari is appropriate to resolve conflicts among Courts of Appeals on significant issues of federal law. Supreme Court Rule 10(a). Indeed, the principal purpose for which this Court uses certiorari jurisdiction is to resolve conflicts among Courts of Appeals concerning the meaning of provisions of federal law. *See, Braxton v. United States*, 500 U.S. 344 (1991); *Acosta v. Louisiana Dep't of Health & Human Resources*, 478 U.S. 251, 253, *reh'g denied*, 478 U.S. 1036 (1986); *Bingler v. Johnson*, 394 U.S. 741 (1969).

This Court has granted certiorari when a conflict has existed among the Circuits on significant bankruptcy law issues. *See, Union Bank v. Wolas*, 502 U.S. 151, 154 (1991) (conflict between Ninth and Sixth Circuits on interpretation of 11 U.S.C. § 547(c)(2)); *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 238 (1989) (conflict between Fourth and Sixth Circuits on interpretation of 11 U.S.C. § 506(b)).

The Ninth Circuit here held that absent some unspecified "legitimate business or economic justification, it is impermissible for" a debtor to classify an unsecured deficiency claim which arises solely by operation of 11 U.S.C. § 1111(b) separately from general unsecured claims (Appendix, page A-15). In *Woodbrook*, the Seventh Circuit held that such a deficiency claim was not "substantially similar" to general unsecured claims and that therefore, pursuant to 11 U.S.C. § 1122(a), such a claim *could not* be classified with general unsecured claims. 19 F.3d at 319.

The 1994 decision of the Seventh Circuit in *Woodbrook* marked the first time that a Circuit Court of Appeals had reached the directly opposite conclusion on the classification issue to that of the Fifth Circuit in *Matter of Greystone*

III Joint Venture, 948 F.2d 134, *republished as corrected*, 995 F.2d 1274 (5th Cir. 1991), *cert. denied*, 506 U.S. 821 (1992). The reasoning of *Greystone* had been endorsed by the Second Circuit in *In re Boston Post Rd. Ltd. Partnership*, 21 F.3d 477 (2nd Cir. 1994), *cert. denied, sub nom Boston Post Rd. Ltd. Partnership v. Federal Deposit Ins. Corp.*, ___ U.S. ___, 115 S.Ct. 897 (1995), by the Third Circuit in *John Hancock Mut. Life Ins. Co. v. Route 37 Business Park Assocs.*, 987 F.2d 154 (3d Cir. 1993), by the Fourth Circuit in *In re Bryson Properties, XVIII*, 961 F.2d 496 (4th Cir. 1992), *cert. denied*, 506 U.S. 866 (1992), and by the Eighth Circuit in *In re Lumber Exchange Bldg. Ltd.*, 968 F.2d 647 (8th Cir. 1992).

In this case, the Ninth Circuit reached the same conclusion as the numerical majority of the Circuits which have ruled on the issue. Nonetheless, the conflict among the Circuits – with the law in the Second, Third, Fourth, Fifth, Eighth and now Ninth Circuits directly contrary to the law in the Seventh Circuit – is clear.

This conflict substantially affects a rule of national application. The entire Bankruptcy Code, including the sections relevant to the Ninth Circuit's decision here and the Seventh Circuit's *Woodbrook* decision (11 U.S.C. §§ 1111(b) and 1122), operates as a unified national system, as required by the Uniformity Clause of the United States Constitution, Article I, § 8. See, *St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525, 1531 (9th Cir. 1994), *as amended by*, 46 F.3d 969 (9th Cir. 1995). The ability, or lack thereof, of a plan proponent to craft a reorganization plan separately classifying an unsecured deficiency claim is purely a matter of bankruptcy law; no state law addresses this issue or is implicated in its analysis.

There is an overriding need for national uniformity with respect to this issue. As noted above, the Uniformity

Clause compels national uniformity. Whether Chapter 11 is, as a practical matter, available as an effective reorganization mechanism should not depend on the Circuit in which the case is filed. Thousands of Chapter 11 cases filed each year in every state are affected by the ability of the debtor to separately classify a deficiency claim; this issue thus affects many thousands of debtors, creditors (both the deficiency claimholders themselves and the other creditors of debtors), and investors. If Barakat had established residency in the Seventh Circuit, his reorganization plan would have advanced to the confirmation stage; in the Ninth Circuit, under the decision here, Barakat's plan is dead on arrival. The 180-degree different interpretations of 11 U.S.C. §§ 1111(b) and 1122 presently effective in the Seventh and Ninth Circuits create different economic outcomes for identically-situated debtors and creditors depending on the Circuit in which the case is heard. This disparity is intolerable in a national system, and violates the Constitution's Uniformity Clause.

The conflict between the Ninth Circuit here and the Seventh Circuit in *Woodbrook* creates differing outcomes on indistinguishable facts. This conflict is direct, clear, and irreconcilable. Certiorari is therefore appropriate.

II. The Ninth Circuit's Opinion Is Inconsistent with Holdings of this Court which Prohibit Lower Courts from Reading Additional Requirements into the Plain Language of Statutes to Achieve "Policy" Objectives.

Certiorari is appropriate when it appears that a decision of a Court of Appeals may be inconsistent with relevant prior decisions of this Court. Supreme Court Rule 10(c). *See, Pure Oil Co. v. Suarez*, 384 U.S. 202 (1966); *United Steelworkers of America, AFL-CIO v. N.L.R.B.*, 376 U.S. 492, *on remand*, 332 F.2d 563, *mot. granted*, 377 U.S. 974 (1964).

Even if this Court has not previously addressed the precise legal issue involved below, certiorari is appropriate when a Court of Appeals makes a ruling which is inconsistent with principles applicable to the matter under prior decisions of this Court. *Parsons v. Smith*, 359 U.S. 215 (1959).

If the Court of Appeals appears to have misinterpreted prior Supreme Court decisions, certiorari is appropriate. *United Gas Pipe Line Co. v. Memphis Light, Gas and Water Div.*, 358 U.S. 103, *reh'g denied*, 358 U.S. 942 (1958).

Here, the Ninth Circuit's decision is utterly inconsistent with the recent and repeated holdings of this Court which prohibit all courts from reading additional requirements into the plain language of unambiguous statutes to achieve desired policy objectives.

11 U.S.C. § 1122(a) provides that a Chapter 11 plan may place a claim "in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class." The statute is therefore clear on its face that dissimilar claims may not be placed in the

same class. Section 1122(a) cannot be read to require that all similar claims be placed in a single class, or to prohibit the separate classification of similar claims. *Matter of Jersey City Medical Center*, 817 F.2d 1055, 1060 (3d Cir. 1987); *In re U.S. Truck Co., Inc.*, 800 F.2d 581, 585 (6th Cir. 1986); *Barnes v. Whelan*, 689 F.2d 193, 201 (D.C. Cir. 1982); *In re Gato Realty Trust Corp.*, 183 B.R. 15, 18-19 (Bankr. D. Mass. 1995); *In re Baldwin Park Towne Center, Ltd.*, 171 B.R. 374 (Bankr. C.D. Cal. 1994); *In re Rivers End Apartments, Ltd.*, 167 B.R. 470, 477-79 (Bankr. S.D. Oh. 1994); *In re SM 104 Ltd.*, 160 B.R. 202 (Bankr. S.D. Fla. 1993); *In re ZRM-Oklahoma Partnership*, 156 B.R. 67 (Bankr. W.D. Ok. 1993).

Here, the Ninth Circuit acknowledged that "the Bankruptcy Code does not expressly state whether the plan may separately classify similar claims, or whether it must classify similar claims together." (Appendix, page A-10). The Ninth Circuit reduced the argument for permitting separate classification of similar claims to one sentence: "simply that the [Bankruptcy] Code does not forbid it *expressly*" (Appendix, page A-11; emphasis added). In other words, the Ninth Circuit considered itself free to find an *implied* restriction not contained in the *express* language of the Bankruptcy Code.

This Court has repeatedly and recently admonished lower courts not to read additional requirements into the plain language of statutes to achieve some purported "policy" objective when the statute itself is clear and unambiguous. When the governing statute is clear and unambiguous on its face, it should be applied as written, unless such a reading would be unconstitutional, or would "produce a result 'demonstrably at odds with the intentions of its drafters.' " *Griffin v. Oceanic Contractors,*

Inc., 458 U.S. 564, 571 (1982); *United States v. Locke*, 471 U.S. 84, 93 (1985). This principle – the plain, unambiguous language of a constitutionally-permissible statute is conclusive in the absence of a clearly expressed legislative intent to the contrary – applies in Bankruptcy Code matters. *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 240-242 (1989); *United States v. Noland*, ___ U.S. ___, 116 S.Ct. 1524 (1996); *In re Bonner Mall Partnership*, 2 F.3d 899, 908 (9th Cir. 1993), *cert. granted, sub nom U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 510 U.S. 1039 (1994), *motion to vacate denied, case dism'd as moot*, 513 U.S. 18 (1994).

Here, the constitutionality of 11 U.S.C. § 1122(a) is not in question. The issue is whether § 1122(a) contains an unwritten, subliminal requirement that all similar claims must be classified together. No sound basis for reading such a requirement into the statute exists.

In *Union Bank v. Wolas*, 502 U.S. 151 (1991), this Court unanimously reversed the Ninth Circuit under the principles stated in *Locke* and *Ron Pair*, in a situation logically similar to that presented here. In that case, a Chapter 7 trustee filed a complaint under 11 U.S.C. § 547(b) against a bank to recover payments made by the debtor to the bank during the 90-day period preceding the filing of the petition. The bank argued that the payments were made in the ordinary course of business pursuant to § 547(c)(2), and were thus excepted from § 547(b). The Bankruptcy Court agreed with the bank, and the District Court affirmed, but the Ninth Circuit reversed, holding that the "ordinary course of business" exception provided by § 547(c)(2) was applicable only to short-term debt, not long-term debt. This Court reversed, holding that *the plain meaning of the statute controlled*, as follows:

> "The most significant feature of [11 U.S.C. § 547(c)(2)] that is relevant to this case is *the absence of any language* distinguishing between long-term debt and short-term debt . . . Thus, the text provides no support for respondent's contention that § 547(c)(2)'s coverage is limited to short-term debt, such as commercial paper or trade debt. *Given the clarity of the statutory text, respondent's burden of persuading us that Congress intended to create or to preserve a special rule* for long-term debt *is exceptionally heavy.*" (Emphasis added) 502 U.S. at 155-156.

Reviewing the legislative history of 11 U.S.C. § 547, this Court again focused on the unambiguous language of the statute:

> "[E]ven if Congress adopted the 1984 amendment to redress particular problems of specific short-term creditors, it remains true that Congress redressed those problems by entirely deleting the time limitation in § 547(c)(2). The fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning." 502 U.S. at 157-158.

Accordingly, the Ninth Circuit here should have gone no further than the unambiguous plain meaning of the language of 11 U.S.C. § 1122(a). Instead, the Ninth Circuit followed the lead of the Second Circuit in *In re Boston Post Rd. Ltd. Partnership*, 21 F.3d 477 (2nd Cir. 1994), *cert. denied, sub nom Boston Post Rd. Ltd. Partnership v. Federal Deposit Ins. Corp.*, ___ U.S. ___, 115 S.Ct. 897 (1995), in acknowledging that "prohibiting the debtor from separately classifying deficiency claims will effectively bar single asset debtors from utilizing the Bankruptcy Code's cramdown provisions," but justifying its deviation from the plain language of the statute on policy grounds: "the

court was not persuaded that a single-asset debtor *should be* able to cramdown a plan that disadvantages the largest creditor" (Appendix, page A-14; emphasis added). Here, the Ninth Circuit acted on the basis of its policy preferences to impose additional requirements on Chapter 11 plan proponents not found in the express language of the relevant statute, in direct contravention of this Court's admonitions in *Locke*, *Ron Pair*, and *Union Bank* to eschew such judicial legislation. Certiorari is therefore appropriate.

III. The Ninth Circuit's Opinion Is Based on a Misapprehension of the Meaning of Two Sections of the Bankruptcy Code: 11 U.S.C. §§ 1111(b) and 1122.

Certiorari is appropriate when it appears that a Court of Appeals may have misapprehended the meaning of a federal statute, thereby thwarting the intent of Congress. *United States v. Noland*, ___ U.S. ___, 116 S.Ct. 1524 (1996) (certiorari granted to determine appropriate scope of Bankruptcy Court's power under 11 U.S.C. § 510(c) to subordinate a tax penalty); *United States v. Hougham*, 364 U.S. 310 (1960), *reh'g denied*, 364 U.S. 938 (1961).

The existence of a direct conflict on a matter of statutory interpretation among Courts of Appeals or lower federal courts is a strong indication that one or more Courts of Appeals may have misapprehended the meaning of the statute. *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552 (1990) (certiorari granted to resolve conflict among Bankruptcy Courts on interpretation of 11 U.S.C. § 1328(a)). Here, the conflict among the Ninth, Second, Third, Fourth, Fifth and Eighth Circuits on one hand and the Seventh Circuit on the other hand is described in Section I above. Many lower courts have

expressed disagreement with the majority of the Circuits as well. *See, e.g., In re Baldwin Park Towne Center, Ltd.*, 171 B.R. 374 (Bankr. C.D. Cal. 1994); *In re ZRM-Oklahoma Partnership*, 156 B.R. 67 (Bankr. W.D. Ok. 1991); *In re SM 104 Ltd.*, 160 B.R. 202, 216-221 (Bankr. S.D. Fla. 1993); *In re Rivers End Apartments, Ltd.*, 167 B.R. 470 (Bankr. S.D. Ohio 1994); *In re Gato Realty Trust Corp.*, 183 B.R. 15 (Bankr. D. Mass. 1995).

The Ninth Circuit's Opinion endorses the notion that a fair literal reading of 11 U.S.C. § 1122(a) would render § 1122(b) superfluous, as "there would be no need for § 1122(b) specifically to authorize a separate class of smaller unsecured claims" (Appendix, page A-11). To the extent the Ninth Circuit's decision is based on this misapprehension of § 1122(b), the Ninth Circuit's decision is flawed.

As noted in *ZRM-Oklahoma Partnership*, 156 B.R. at 70, the contention that 11 U.S.C. § 1122(b) is rendered meaningless if § 1122(a) allows a debtor to separately classify similar claims "requires one to turn the meaning of § 1122(a) upside down. Section 1122(a) speaks solely to which claims may not be classified together, while § 1122(b) creates the one exception to that rule for dissimilar, *de minimis* unsecured claims." Thus, claims with dissimilar rights against the debtor – e.g., priority and non-priority claims, subordinated and unsubordinated claims (and, at least in the Seventh Circuit, non-recourse mortgage deficiency claims and other unsecured claims) – but which are unsecured and relatively small can be placed in the same class pursuant to § 1122(b), even though such claims are not "substantially similar" as required by § 1122(a). The chief logical underpinning of the case most relied on by the Ninth Circuit, *Matter of*

Greystone III Joint Venture, 948 F.2d 134, *republished as corrected*, 995 F.2d 1274 (5th Cir. 1991), *cert. denied*, 506 U.S. 821 (1992), is flawed because the Fifth Circuit (and the Ninth Circuit here) overlooked that § 1122(b) applies to unsecured claims with *different* rights and priorities against the debtor, and is therefore a meaningful exception to the "substantially similar" requirement of § 1122(a) without going beyond the plain meaning of § 1122(a).

Further, the Ninth Circuit's Opinion is based on a misapprehension of the language, intent, and effect of 11 U.S.C. § 1111(b). The Ninth Circuit's reasoning that separate classification would mean that the undersecured creditor's voting rights are effectively eliminated is untenable. Placement of any claim into its own class hardly "disenfranchises" a claimholder. Instead, the separately classified creditor clearly controls one class, as to which all of the § 1129(b) tests must be met before the plan can be approved by cramdown over that sole creditor's rejection.

Moreover, insisting that an unsecured deficiency claim be classified with all other unsecured debt leads to anomalies in the application of 11 U.S.C. § 1111(b), as set out in *Matter of Woodbrook Assocs.*, 19 F.3d 312, 319 (7th Cir. 1990) and *SM 104 Ltd.*, 160 B.R. at 219-221. As those cases make clear, because the § 1111(b)(2) election is made by "the class of which such claim is a part," the general unsecured creditors included in a class with the deficiency claimholder would be able to vote on whether the deficiency claimholder can make the § 1111(b)(2) election. Even if the deficiency claimholder is over two-thirds in dollar amount of the class, the other unsecured creditors constituting a majority in number of the allowed

unsecured claims can block the § 1111(b)(2) election by the deficiency claimholder. Thus, in this case, the Ninth Circuit's decision effectively surrenders the deficiency claimholder's right to make the § 1111(b)(2) election to Barakat's 43 other non-priority unsecured creditors. Even more absurdly, in any case in which the deficiency claim is less than one-third of the unsecured claim total, the other unsecured creditors could force a § 1111(b)(2) election on an unwilling deficiency claimholder classmate.

For this reason, the conclusion that 11 U.S.C. § 1111(b) is rendered meaningless by separate classification of an undersecured creditor's deficiency claim is exactly backwards. If the deficiency claim is separately classified, the deficiency claimholder is in total control of its election under § 1111(b). Thus, separate classification enhances the undersecured creditor's § 1111(b) rights, rather than limiting them.

By enabling the undersecured creditor to capture the appreciation in its collateral before unsecured creditors share in it, 11 U.S.C. § 1111(b) was intended to be one of the undersecured creditor's primary protections in cramdown plans, and is discussed as such at length in the Legislative Statement to § 1129. Ironically, the rule announced here by the Ninth Circuit will induce undersecured creditors to not make this election, because making the § 1111(b) election eliminates their unsecured claims and, with them, the power to effectively veto a plan.

IV. The Ninth Circuit's Opinion Decides an Important Question of Federal Law that Has Not Been, But Should Be, Settled by this Court.

Certiorari is appropriate when a Court of Appeals has decided an important question of federal law that has not been, but should be, settled by this Court. Supreme Court Rule 10(c). When the question is recurring and the case involves principles the settlement of which is of importance to the public, certiorari should be granted. *See, e.g., Donaldson v. United States*, 400 U.S. 517 (1971); *United States v. Zacks*, 375 U.S. 59 (1963). This principle applies in bankruptcy matters. *See, e.g., United States v. Noland*, ___ U.S. ___, 116 S.Ct. 1524 (1996).

The Bankruptcy Court below termed the claims classification issue decided in this case "one of the recent hot topics in bankruptcy law" (Appendix, page A-65). Few, if any, topics in bankruptcy law since the jurisdictional controversies resolved by this Court in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982) have generated the quantity of commentary and divergence of opinion found in case law and professional literature since the Fifth Circuit's decision in *Matter of Greystone III Joint Venture*, 948 F.2d 134, *republished as corrected*, 995 F.2d 1274 (5th Cir. 1991), *cert. denied*, 506 U.S. 821 (1992). The fact that lower courts and commentators have continued to disagree about the proper resolution of the questions presented renders certiorari appropriate. *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 238 (1989).

The 15 cases cited herein on the issue of whether 11 U.S.C. § 1122 mandates that all similar claims be classified together are by no means all of the cases on the

subject. In addition, law professors, practicing bankruptcy lawyers, and law students have weighed in on the classification issue in literally hundreds of treatises, journal articles, and law review notes.[2]

While this issue has been decided in seven Circuits, the remaining Circuits have not yet spoken to the issue. Moreover, even in the Ninth Circuit and the other Circuits which have adopted the *Greystone* rule, individual Bankruptcy Court judges can be expected to temper their application of the rule to the extent that the judge disagrees with it. A prime example is *In re Baldwin Park Towne Center, Ltd.*, 171 B.R. 374 (Bankr. C.D. Cal. 1994), which was decided one week prior to the Bankruptcy Court ruling herein. In that case, another bankruptcy judge in the Central District of California voiced his disagreement with the Bankruptcy Appellate Panel decision in *In re Tucson Self-Storage, Inc.*, 166 B.R. 892 (Bankr. 9th Cir. 1994), the decision which was followed here by

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[2] A recent count showed at least 255 legal journal and law review articles since 1992 discussing the issue presented herein. The following list identifies some of the most thorough analyses of the issue, omitting hundreds of articles and notes which make a more matter-of-fact statement of the issue (again, no claim is made that this list is exhaustive):

Bigosinski, *Bankruptcy-Reorganization and Classification of Claims-Debtor Filing for Bankruptcy Under Chapter 11 of the Bankruptcy Code Must Have a Reasonable Basis for Classifying Similar Claims in Separate Classes*, 23 Seton Hall L.Rev. 1938 (1993).

Carlson, *The Classification Veto in Single-Asset Cases Under Bankruptcy Code Section 1129(a)(10)*, S.C. L.Rev. 565 (Summer 1993).

Carlson, *Artificial Impairment and the Single Asset Chapter 11 Case*, 23 Cap. U. L.Rev. 339 (1994).

the Bankruptcy Court (albeit reluctantly), and the reasoning of which was adopted by the District Court and the Ninth Circuit herein. Through artful analysis, the *Baldwin*

Jones, *The Classification and Cramdown Controversy in Single Asset Bankruptcy Cases: A Need for the Repeal of Bankruptcy Code Section 1129(A)(10)*, 42 U.C.L.A. L.Rev. 623 (1994)

Krause, *The Bias of the Courts Against Single-Asset Real Estate Cases is Creating Bad Law in the Area of Classification*, 22 Cal.Bankr.J. 47 (1994)

Markell, *Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification*, 11 Bankr. Dev. J. 1 (1994-95).

Meltzer, *Disenfranchising the Dissenting Creditor through Artificial Classification or Artificial Impairment*, 66 Am. Bankr. L. J. 281 (1992).

Miller, Practising Law Institute-Commercial Law and Practice Course Handbook Series, *Classification of Claims in Chapter 11 Plans Under the Bankruptcy Code*, 738 PLT/Comm 227 (1996).

Neuger, *The Authority of a Debtor to Place Substantially Similar Claims Into Separate Classes In Order to Cram Down a Reorganization Plan: Should a Bright Line Rule Requiring All Substantially Similar Claims to Be Placed In a Single Class Be Adopted?* 9 Bankr. Dev. J. 567 (1993).

Norberg, *Classification of Claims Under Chapter 11 of the Bankruptcy Code: The Fallacy of Interest Based Classification*, 69 Am. Bankr. L.J. 119 (Spring 1995).

Robin, *Classification of Claims: An Examination of Disregarded Legislative History*, 98 Com. L.J. 225 (1993).

Rusch, *Gerrymandering the Classification Issue in Chapter 11 Reorganization*, 63 U. Colo. L. Rev. 163 (1992).

Rusch, *Single Asset Cases in Chapter 11: The Classification Quandary*, 1 Am. Bankr. Inst. L.Rev. 43 (1993).

Unger, *Prohibiting Multiple Classification and Artificial Impairment in Single Asset Chapter 11 Cases: The Creditor's Veto – Its Power Congress Did Not Intend*, 23 Cap. U. L.Rev. 541 (1994).

Park court reached the conclusion that under the principles announced in *Tucson*, valid business reasons justified, and indeed mandated, the separate classification of the undersecured creditor's unsecured non-recourse mortgage deficiency claim. The *Baldwin Park* court enumerated six factors leading to this conclusion:

(1) The undersecured creditor was provided the full value of its secured claim;

(2) The undersecured creditor had recourse on its claim under 11 U.S.C. § 1111(b)(1)(A), which is contrary to state law;

(3) The debtor had to pay trade claims in full in order to satisfy 11 U.S.C. § 1129(a)(7), while § 1129(a)(7) does not require any payment to the undersecured creditor on account of its deficiency claim;

(4) In a Chapter 7 case and under state law, unsecured creditors could seek payment from all of the debtor's assets, while the undersecured non-recourse creditor is limited to recovering from its security;

(5) Unsecured trade claimants could pursue the general partner of the debtor for recovery, while the undersecured non-recourse creditor had recourse only against the property; and

(6) The undersecured creditor had a right to treat its deficiency claim as a fully secured claim under 11 U.S.C. § 1111(b)(2). 171 B.R. 377.

In holding that, under *Tucson*, the presence of the above-stated factors *required* separate classification of the undersecured creditor's deficiency claim, the *Baldwin Park* court ruled:

> "Accordingly, based on my evaluation of the nature, kind, species and character of the Deficiency and Trade Claims, I find the Deficiency

> Claim substantially different from the Trade Claims. Since they are substantially different, they not only should, but *must*, be classified separately." 171 B.R. at 377 (emphasis added).

Here, Barakat seeks to reorganize an income-producing property which, as in *Baldwin Park*, is subject to the non-recourse obligation of an insurance company. *All* of the six factors enumerated by the Bankruptcy Court in *Baldwin Park* as leading to the conclusion that valid business reasons justified the separate classification were present in the case herein; indeed, the presence of each *Baldwin Park* factor was not in dispute herein. Barakat submits the *Baldwin Park* factors are likely to be present in many, if not most, single asset real estate Chapter 11 cases. *Baldwin Park* thus represents one Bankruptcy Judge's valiant effort to avoid the harsh and incorrect outcome of *Tucson*. Not having the benefit of the six-point test crafted in *Baldwin Park*, the Bankruptcy Court here saw no significant factual differences between the case here and that of *Tucson*, and so followed the Bankruptcy Appellate Panel's decision in *Tucson* due to stare decisis, even though the Bankruptcy Court believed *Tucson* to have been wrongly decided.

Another illustration of the lengths to which courts will go to avoid the effect of *Tucson* is *In re Elmwood, Inc.*, 182 B.R. 845 (D. Nev. 1995). In that case, the separate classification of a deficiency claim in a plan was authorized under *Tucson* on the basis of the different means proposed in the plan for repayment of such claim.

Inconsistency among the Circuits, and even within lower courts within a Circuit on the basis of judges applying the law to achieve a desired outcome (such as the dichotomy between the Bankruptcy Court decision here and that in *Baldwin Park*, and the huge loophole

erected by *Elmwood*), leads to differing economic outcomes in cases with indistinguishable fact patterns. This manifest unfairness can be put to rest if this Court grants certiorari and ultimately decides the important issues presented herein, which have spawned such a volume of contradictory case law and scholarly commentary.

V. The Ninth Circuit's Opinion Endorses Policy Which Is Unsupported by the Bankruptcy Code and Was Rejected by Congress in 1978 and 1994.

As discussed above, this Court's determination on whether to grant certiorari turns on the existence of a conflict among the Courts of Appeals on a significant issue of bankruptcy law, and on Barakat's showing that the Ninth Circuit Opinion is inconsistent with prior decisions of this Court requiring all courts to apply statutes as written, without policy-driven additions and modifications being grafted onto clear and unambiguous statutory language. The statutes at issue here – 11 U.S.C. §§ 1111(b) and 1122 – are clear, unambiguous, and part of a consistent statutory framework governing Chapter 11 plans. Accordingly, policy considerations about what the law *should be* in this context are beyond the province of the judiciary.

Nonetheless, to the extent that the validity of the policy considerations endorsed by the Ninth Circuit are at issue with respect to this petition, Barakat submits that the Ninth Circuit decided this case on policy grounds which are poorly reasoned, and which were rejected by Congress in enacting the Bankruptcy Code in 1978, and again in enacting the 1994 Bankruptcy Reform Act.

The fact that § 1122(a) does not prohibit the separate classification of similar claims cannot be considered to be

an omission by Congress which the judiciary is empowered to rectify. If Congress had intended to require that all similar claims be classified together, Congress could have easily said so. In *In re U.S. Truck*, 800 F.2d 581, 585 (6th Cir. 1986), the Sixth Circuit reviewed the predecessors to § 1122 and determined as follows:

> "Further evidence that Congress intentionally failed to impose [in § 1122] a requirement that similar claims be classified together is found by examining the 'classification' sections of the former Bankruptcy Act. . . . [Bankruptcy Act] Section 597 was interpreted to require all creditors of equal rank with claims against the same property to be placed in the same class. [Citations omitted]. Congress' switch to less restrictive language in § 1122 of the Code seems to warrant a conclusion that Congress no longer intended to impose the now-omitted requirement that similar claims be classified together."

Moreover, examination of the legislative history of § 1122 shows that "Congress did not intend to force debtors to place substantially similar claims in the same class." Gregory K. Jones, *The Classification and Cramdown Controversy in Single Asset Bankruptcy Cases: A Need for the Repeal of Bankruptcy Code Section 1129(a)(10)*, 42 U.C.L A. L. Rev. 623, 637 (1994). As Mr. Jones notes:

> "Before drafting the Bankruptcy Code, Congress received recommendations from the Commission on Bankruptcy Laws of the United States and the National Conference of Bankruptcy Judges. Both groups proposed classification sections requiring debtors to place substantially similar claims in the same class. Yet, Congress did not adopt these sections. Congress's section was not revised during the editing process, and it was evidentially codified as Section 1122. As

> Professor Rusch wrote, '[t]he rejection of the language of the Commission's bill . . . undermine[s] the Creditor's classification argument'.
>
> Both an analysis of Section 1122's 'plain meaning' and an analysis of § 1122's legislative history support the single asset debtor's arguments for separate classifications. Debtors should be able to separately classify substantially similar claims in single asset cases. Thus, recent case law prohibiting separate classification is flawed." Jones, *supra* at 637.

See also, Jeffrey C. Krause, *The Bias of the Courts Against Single-Asset Real Estate Cases is Creating Bad Law in the Area of Classification*, 22 Cal.Bankr.J. 47, 49-53 (1994).

If Congress had blundered in allowing debtors to separately classify similar claims in its enactment of 11 U.S.C. § 1122, the 1994 Bankruptcy Reform Act represented a golden opportunity to rectify its error. If fact, Congress considered a host of proposals specifically addressing single asset real estate cases before enacting the Bankruptcy Reform Act of 1994. The limited ways in which Congress affected the bankruptcy rights of single asset real estate debtors undercuts the doubt voiced by the Ninth Circuit in this case (and by the Second Circuit in *In re Boston Post Rd. Ltd. Partnership*, 21 F.3d 477 (2nd Cir. 1994), *cert. denied, sub nom Boston Post Rd. Ltd. Partnership v. Federal Deposit Ins. Corp.*, ___ U.S. ___, 115 S.Ct. 897 (1995)), about whether reorganization *should be* available at all to such debtors (Appendix, page A-14). The Bankruptcy Reform Act enacted a definition of "single asset real estate" (11 U.S.C. § 101(51B)), and provided new protection for creditors with secured interests in single asset real estate at § 362(d)(3). That section provides that the automatic stay can be lifted for a creditor

whose claim is secured by single asset real estate unless, within 90 days after entry of the order for relief, the debtor has filed a reorganization plan that has a reasonable possibility of being confirmed within a reasonable time, or has commenced monthly payments to all creditors secured by the real estate in an amount equal to fair market interest on the value of the creditor's interest in the real estate.

As shown by new 11 U.S.C. §§ 101(51B) and 362(d)(3), Congress has recently addressed the lenders' lobby concerns about perceived abuse of the Bankruptcy Code by single asset real estate debtors. Judicial creation of additional restrictions on single asset real estate debtors on policy grounds constitutes unjustified legislation by the judiciary.

The Ninth Circuit has previously recognized the economic and societal benefits of reorganization by encouraging the investment of new capital, thereby preserving the going concern value of the debtor's enterprise. This is the underlying policy reason for the "new value exception" to the absolute priority rule. *In re Bonner Mall Partnership*, 2 F.3d 899, 908 (9th Cir. 1993), *cert. granted, sub nom U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 510 U.S. 1039 (1994), *motion to vacate denied, case dism'd as moot*, 513 U.S. 18 (1994). As the Ninth Circuit recognized here, the rule of this case – that deficiency claimholders and other unsecured creditors must be in a single class, absent some extraordinary circumstance – makes the confirmation of new value plans in single-asset real estate cases virtually impossible. The imposition of judicially-created limitations on a debtor's ability to classify claims in a manner designed to preserve economic value for all of a debtor's creditors is short-sighted. The

requirement of 11 U.S.C. § 1129(a)(10) was not meant to preclude confirmation of a plan which would benefit unsecured creditors generally, solely because an obstinate undersecured creditor wishes to exercise veto rights not expressly granted to it by any provision of the Bankruptcy Code. Even if there were no valid social policy inherent in reorganizing single-asset real estate debtors, the use of judicially created limitations on the right to classify creditors as the means to a desired end is disingenuous and ultimately dangerous.

CONCLUSION

For the foregoing reasons, this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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January 17, 1997

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In re Mohammad Samih BARAKAT, Debtor.

Mohammad Samih BARAKAT, Appellant,

v.

The LIFE INSURANCE COMPANY OF VIRGINIA, Appellee.

No. 95-55709.

United States Court of Appeals, Ninth Circuit.

Argued and Submitted Aug. 5, 1996.

Decided Nov. 12, 1996.

Undersecured creditor, which had filed prepetition complaint for judicial foreclosure of building owned by Chapter 11 debtor, moved for relief from automatic stay. The Bankruptcy Court, 173 B.R. 672, granted relief from stay, and denied plan confirmation for lack of assent of impaired noninsider class of creditors. Debtor appeals, and the United States District Court for the Central District of California, John G. Davies, J., affirmed. Debtor appealed. The Court of Appeals, Restani, J., sitting by designation, held that: (1) plan could not separately classify unsecured mortgage deficiency claim from class of general unsecured creditors; (2) separate classification of unsecured prepetition claims of trade creditors who were continuing to do business with debtor was also impermissible; and (3) tenant security deposit claimants were not

"impaired" classes eligible to vote on plan for purposes of effecting cramdown.

Affirmed.

Mark T. Young, Marc A. Lieberman, and Steven M. Mayer, Mayer, Glassman & Gaines, Los Angeles, CA, for appellant.

Jeffrey I. Golden and Jennifer Ann Golison, Albert, Weiland & Golden, Costa Mesa, CA, for appellee.

Appeal from the United States District Court for the Central District of California, John G. Davies, District Judge, Presiding. D.C. No. CV-94-6462-JGD.

Before: FLETCHER and TASHIMA, Circuit Judges, and RESTANI,* United States Court of International Trade Judge.

RESTANI, Judge.

Debtor-appellant Mohammad Samih Barakat ("Barakat" or "Debtor") sought confirmation of a Plan of Reorganization (the "Plan") filed under Chapter 11 of the Bankruptcy Code. The bankruptcy court denied confirmation of the Plan, finding that it was impermissible for the Plan to: (1) separately classify from the class of general unsecured creditors the unsecured mortgage deficiency claim of The Life Insurance Company of Virginia; (2) separately classify the unsecured pre-bankruptcy claims of creditors who continue to do business with Debtor;

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* Honorable Jane A. Restani, Judge, United States Court of International Trade, sitting by designation.

and (3) identify security deposit creditors as an "impaired" class. Debtor appealed the bankruptcy court's findings to the district court, which affirmed. We have jurisdiction over this appeal pursuant to 28 U.S.C. § 158(d), and we affirm the district court.

FACTUAL BACKGROUND

Kittridge Garden Associates ("KGA"), a California general partnership, owned and managed an 85-unit, three-story residential apartment building located at 14420 Kittridge Street, Van Nuys, California (the "Kittridge property"). On August 25, 1988, KGA executed a promissory note, secured by a first deed of trust on the Kittridge property, in favor of The Life Insurance Company of Virginia ("LICV"). The note was in the principal sum of $4,550,000, with an annual interest rate of 9.625%.

In May 1989, KGA conveyed all of its rights in the Kittridge property to Barakat and four relatives (the "Barakat Group").[1] The Barakat Group paid $2,470,000 in cash, and assumed KGA's obligations under the promissory note. At the time, the balance due on the note was $4,410,000.

The Barakat Group made all payments on the note until June 1993. According to appellant, the recession in 1993 increased the vacancy rate and forced the Kittridge property to operate at a loss. On June 13, 1993, title to the Kittridge property was consolidated in Barakat and his

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[1] The Barakat group included Adil Barakat and Rihab Barakat, husband and wife, Siham Barakat, Debtor's wife, and Nabil Y. Barakat.

wife by quitclaim deed from the other members of the Barakat Group.[2] Barakat thereafter defaulted on the payments to LICV. After unsuccessful negotiations to restructure the promissory note, LICV sought judicial foreclosure and the appointment of a receiver. On October 22, 1993, Barakat filed for relief under Chapter 11 of the Bankruptcy Code, thereby staying LICV's foreclosure action.

As of the date of Debtor's petition, the only secured claim against the property was held by LICV. According to LICV, Debtor owed more than $4,669,001 on the promissory note. The district court found the value of the Kittridge property to be $3,970,000.

On November 17, 1993, LICV filed a motion seeking relief from the automatic stay. On January 13, 1994, the bankruptcy court granted LICV's motion in part, modifying the automatic stay to allow LICV to pursue either judicial or nonjudicial foreclosure against the Kittridge property, except that LICV could not proceed with the foreclosure sale without further order of the bankruptcy court. The bankruptcy court denied LICV's request to appoint a receiver.

On June 20, 1994, Debtor sought the bankruptcy court's approval of an amended disclosure statement[3] and plan of reorganization. The disclosure statement and plan provided for reduction of LICV's secured claim to

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[2] The deed was recorded on August 16, 1993.

[3] A previously filed disclosure statement was withdrawn by Debtor.

$3,970,000, the fair market value of the property and proposed seven classes.[4]

The bankruptcy court identified several problems with the plan. First, LICV's deficiency claim[5] should have been part of the general unsecured class. Second, there

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[4] The district court noted the proposed classes as follows:

Class 1, LICV's secured claim in the amount of $3,970,000 (secured by the [Kittridge] property);

Class 2, priority claims for individual tenant pre-petition security deposits to the extent of $900 per tenant. The class consisted of 51 claimants and $29,960 in claims. The claims were entitled to priority under [§] 507(a)(6) of the Bankruptcy Code;

Class 3, LICV's unsecured deficiency claim (the unsecured portion of the LICV note, also defined as the difference between the amount owed under the LICV note as of the commencement date and the Class 1 claim). The amount of the deficiency claim was $570,088.36;

Class 4, non-priority claims of tenants for prepetition security deposits. The class consisted of eighteen claimants, and $3,085 in claims;

Class 5, general unsecured claims that were not separately classified. The class consisted of ten claimants, and total claims of $21,616.22;

Class 6, general unsecured claims held by creditors who continued to do business with Debtor after Debtor filed his petition. These creditors have an ongoing business relationship with Debtor. The class consisted of thirteen claimants, and total claims of $20,434;

Class 7, general unsecured claims held by insiders of Debtor. The class consisted of two claimants, and total claims of $29,516.31.

Appellant's Excerpts of Record ("ER") at 217-18.

[5] LICV's deficiency claim amounted to $570,088.36. ER at 217.

was no justification for separately classifying the pre-bankruptcy claims of ongoing trade creditors from other unsecured debt. Third, under the plan, security deposit creditors were not impaired. The court allowed Debtor to correct these problems and amend the proposed disclosure statement. ER at 195.

On August 2, 1994, Debtor filed a Second Amended Plan of Reorganization ("the Plan") and a Second Amended Disclosure Statement. The bankruptcy court reviewed the plan and found that the only change made by Debtor was that Debtor's relatives would contribute $50,000 in cash. ER at 196. LICV challenged the new plan on several grounds.

The bankruptcy court found that it was bound by the Ninth Circuit Bankruptcy Appellate Panel's ("BAP") decision in *Oxford Life Ins. Co. v. Tucson Self-Storage, Inc.* (*In re Tucson Self-Storage*), 166 B.R. 892 (BAP 9th Cir. 1994), holding that it was impermissible, absent a business justification, to separately classify a deficiency claim from the general unsecured class. Finding no business justification, the bankruptcy court denied Debtor's separate classification of LICV's deficiency claim. ER at 197. The bankruptcy court further found that the claims of security deposit creditors were not impaired under the Plan. ER at 209. Finally, there was no justification to separately classify the prebankruptcy claims of ongoing trade creditors from those of general unsecured creditors. ER at 210.

Under these rulings, the plan could not be confirmed. LICV, the largest unsecured claimant, represented at least two-thirds in amount of the allowed interests in the class.

Under § 1126(c),[6] it would have to accept the Plan for the class to accept. *See* 11 U.S.C. § 1126(c). LICV would not accept the Plan because it sought to foreclose on its security. As no impaired accepting class existed, other than insiders who have no authority to vote for this purpose, the Bankruptcy Code requirements for Plan acceptance were not satisfied. The Plan could not obtain the vote of a legitimately impaired class of non-insider creditors as required under 11 U.S.C. § 1129(a)(10).

On August 15 & 16, 1994, the bankruptcy court entered orders granting LICV's motion for relief from the automatic stay, and denying approval of Debtor's second amended disclosure statement. Debtor appealed these decisions to the district court. The bankruptcy court granted Debtor's motion for a stay pending appeal. The district court affirmed the bankruptcy court's rulings, finding that (1) the bankruptcy court correctly found that it was bound by the BAP's decision in *Tucson Self-Storage*, (2) separate classification of LICV's deficiency claim was impermissible, (3) tenant security deposit creditors were not impaired under the Plan, and (4) separate classification of the claims of ongoing trade creditors was impermissible. ER at 220-230. Debtor appeals from the final judgment of the district court.

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[6] Unless otherwise noted, all citations are to the Bankruptcy Code, Title 11, United States Code, in effect prior to the 1994 amendments.

STANDARD OF REVIEW

On appeal from a final judgment of the district court reviewing a decision of the bankruptcy court, we review the bankruptcy court's factual findings for clear error and the district court's legal conclusions *de novo*. *See Henderson v. Buchanan*, 985 F.2d 1021, 1023-24 (9th Cir.1993). The bankruptcy court's finding that a claim is or is not substantially similar to other claims, constitutes a finding of fact reviewable under the clearly erroneous standard. *Steelcase Inc. v. Johnston* (In re Johnston), 21 F.3d 323, 327 (9th Cir.1994). A legal issue, however, underlies the classification here. That is, is there any limitation on the separate classification of similar unsecured claims. The court resolves such issues *de novo*. *See id.* at 328-29; *Vanderpark Properties Inc. v. Buchbinder* (*In re Windmill Farms*), 841 F.2d 1467, 1469 (9th Cir.1988).

DISCUSSION

A. *Unsecured Deficiency Claim*

Under § 1129(a), the bankruptcy court may confirm a plan of reorganization if each class of impaired claims accepts the plan, 11 U.S.C. § 1129(a)(8), or at least one class of claims that is impaired under the plan accepts the plan, "without including any acceptance of the plan by any insider." 11 U.S.C. § 1129(a)(10). Section 1129(b)(1) provides for a "cramdown" procedure. 11 U.S.C. § 1129(b)(1) note (Legislative Statements). That provision allows confirmation over the objection of dissenting

classes provided the plan is fair and equitable[7] and does not unfairly discriminate against any impaired claims, 11 U.S.C. § 1129(b), and the plan meets all the statutory requirements of § 1129(a).

In this case, a secured creditor, LICV, held a claim against Debtor that exceeded the value of the collateral, thus implicating 11 U.S.C. §§ 506(a) & 1111(b). Section 506(a) provides that a claim secured by a lien on property is considered secured up to the value of such property and unsecured for the remainder. Under § 1111(b)(2),[8] the creditor class may elect to have the claim allowed as a secured claim for the full contractual amount rather than

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[7] "Fair and equitable" historically has included a requirement that no class subordinate to the dissenting class may take anything pursuant to a reorganization plan. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202, 108 S.Ct. 963, 966, 99 L.Ed.2d 169 (1988). This requirement is codified at 11 U.S.C. § 1129(b)(2)(B)(ii). *Id.*

[8] Section 1111(b) provides, in relevant part, as follows:

(b)(1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless –

(i) the class of which such claim is a part elects, by at least two-thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection; . . .

. . . .

(2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.

11 U.S.C. § 1111(b).

the amount of the collateral's value. LICV did not make the § 1111(b)(2) election, presumably so that it could vote as a general unsecured creditor in the amount of its deficiency claim.

Under the Plan, Debtor classified LICV's unsecured deficiency claim separately from other general unsecured claims for the purpose of creating an impaired class that would accept the Plan. If LICV's deficiency claim were classified with other unsecured claims, the Plan could not be accepted so long as LICV, the largest unsecured claimant, objected, and no other impaired class existed to accept the Plan. *See* 11 U.S.C. § 1126(c).

Debtor argues that it was permissible to separately classify LICV's unsecured deficiency claim from the claims of general unsecured creditors pursuant to the unambiguous language of § 1122(a). Section 1122 provides that

> (a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.
>
> (b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

11 U.S.C. § 1122. While dissimilar claims may not be put in the same class, the Bankruptcy Code does not expressly state whether the plan may separately classify similar claims, or whether it must classify similar claims together. Courts disagree on this issue. *Compare Phoenix*

Mut. Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III), 995 F.2d 1274, 1278 (5th Cir.1991), *cert. denied*, 506 U.S. 821, 113 S.Ct. 72, 121 L.Ed.2d 37 (1992) *with In re ZRM-Oklahoma Partnership*, 156 B.R. 67, 70 (Bankr.W.D.Okla.1993). The argument for permitting separate classification of similar claims is simply that the Code does not forbid it expressly. The "plain language of the statute [§ 1122(a)] does not alone support any other restriction" than prohibiting the single classification of dissimilar claims. *ZRM-Oklahoma Partnership*, 156 B.R. at 70. A counter argument is that a wholly permissive view of classification of similar classes would render § 1122(b) superfluous, as "there would be no need for § 1122(b) specifically to authorize a separate class of smaller unsecured claims." *Greystone III*, 995 F.2d at 1278.

Most courts have agreed that § 1122 contemplates some limits on the separate classification of similar claims. *See, e.g., Greystone III*, 995 F.2d at 1279. Although noting that similar claims may be placed in different classes, the court in *Greystone* found that "[there is] one clear rule that emerges from otherwise muddled caselaw on § 1122 claims classification: thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan." 995 F.2d at 1279; *see Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co.* (In re U.S. Truck Co.), 800 F.2d 581, 586 (6th Cir.1986). This principle has been adopted by a majority of the Circuits that have addressed the issue. *See, e.g., Boston Post Rd. Ltd. v. Federal Deposit Ins. Corp.* (In re Boston Post Rd.), 21 F.3d 477, 483 (2d Cir.1994), *cert. denied*, ___ U.S. ___, 115 S.Ct. 897, 130 L.Ed.2d 782 (1995); *Travelers Ins. Co. v. Bryson Properties XVIII* (In re Bryson

Properties), 961 F.2d 496, 502 (4th Cir.1992) ("[A]though [sic] separate classification of similar claims may not be prohibited, it 'may only be undertaken for reasons independent of the debtor's motivation to secure the vote of an impaired, assenting class of claims.' ") (*quoting Greystone III*, 948 F.2d at 139), *cert. denied*, 506 U.S. 866, 113 S.Ct. 191, 121 L.Ed.2d 134 (1992); *In re Holywell Corp.*, 913 F.2d 873, 880 (11th Cir.1990) ("[I]f the classifications are designed to manipulate class voting . . . , the plan cannot be confirmed."). *But see ZRM-Oklahoma*, 156 B.R. at 70 (arguing that even if debtor gerrymanders confirmation vote, other sections of the Bankruptcy Code adequately protect creditors, such as § 1129(b) (nondiscriminatory & fair and equitable requirement), § 1129(a)(7) (best interests of creditors test), § 1111(b) (recourse election)).

Here, Debtor argues that separate classification of LICV's deficiency claim was not solely to manipulate class voting. Instead, Debtor contends that LICV's claim was not "substantially similar" to the other general unsecured claims. On this issue Debtor primarily relies upon *In re Woodbrook Assocs.*, 19 F.3d 312 (7th Cir.1994).

In *Woodbrook*, the court concluded that it was permissible to separately classify an unsecured deficiency claim created by § 1111(b) from general unsecured claims. The court noted that

> [s]ignificant disparities . . . exist between the legal rights of the holder of a [§]1111(b) claim and the holder of a general unsecured claim which render the two claims not substantially similar and which preclude the two from being classified together under [§]1122(a). Thus, we cannot accept the proposition . . . that separate

> classification of a [§]1111(b) claim is nearly conclusive evidence of a debtor's intent to gerrymander an affirmative vote for confirmation. These disparities in rights stem from the most obvious difference between the two claims: a general unsecured claim exists in all chapters of the Code, while a [§]1111(b) claim exists only as long as the case remains in Chapter 11 and, once converted to a Chapter 7 case, recovery is limited to its collateral.

Id. at 318. *See also In re SM 104 Ltd.*, 160 B.R. 202, 218-221 (Bankr.S.D.Fla.1993) (holding § 1111(b) claim not "substantially similar" to general unsecured claims, thus rendering debtor's intent for classification irrelevant); *Principal Mutual Life Ins. Co. v. Baldwin Park Towne Ctr., Ltd.* (In re Baldwin Park Towne Ctr., Ltd.), 171 B.R. 374, 377 (Bankr.C.D.Cal.1994) (finding "nature, kind, species and character" of unsecured deficiency claim substantially different from general unsecured claims).

Although this Circuit has not addressed this issue, a number of courts declined to allow separate treatment based solely on the distinction that the claim is created by operation of law. *See, e.g., Lumber Exchange Bldg. Ltd. Partnership v. Mutual Life Ins. Co. of New York* (*In re Lumber Exchange Bldg. Ltd.*), 968 F.2d 647, 649 (8th Cir.1992) (rejecting argument that separate classification was warranted because creditor's unsecured recourse claim arose by operation of law under 11 U.S.C. § 1111(b)); *Greystone III*, 995 F.2d at 1279-80. In *Greystone III*, the court noted that § 1111(b) not only creates recourse claims where state antideficiency laws would abolish them, but also provides the undersecured creditor an election with respect to the treatment of its deficiency claim. 995 F.2d at

1279. Separate classification of similar claims by virtue of the legal rights of the holder of a § 1111(b) claim, the court concluded, would render the § 1111(b) election "meaningless," as "[p]lan proponents could effectively disenfranchise the holders of such [unsecured deficiency] claims by placing them in a separate class and confirming the plan over their objection by cramdown." *Id.* at 1280. Thus, the court found that, absent valid business justifications, separate classification of a Code-created deficiency claim was impermissible. *Id.*

In *Boston Post Rd.*, 21 F.3d at 483, the Second Circuit also held that separate classification for the purpose of preventing the undersecured creditor from rejecting the plan is contrary to the principles underlying the Bankruptcy Code, that is, that creditors holding greater debt should have a comparably greater voice in reorganization. The court stated:

> The purpose of the Section 1111(b) election is to allow the undersecured creditor to weigh in its vote with the votes of the other unsecured creditors. Allowing the unsecured trade creditors to constitute their own class would effectively nullify the option that Congress provided to undersecured creditors to vote their deficiency as unsecured debt.

Id. Although the court noted that prohibiting the debtor from separately classifying deficiency claims will effectively bar single asset debtors from utilizing the Bankruptcy Code's cramdown provisions, the court was not persuaded that a single-asset debtor should be able to cramdown a plan that disadvantages the largest creditor.

Id. Thus, absent a legitimate business or economic reason, separate classification is not permitted. *Id.*

The Ninth Circuit BAP decision in *Tucson Self-Storage*, 166 B.R. at 897, agreed with the "one clear rule" discussed by *Greystone III*, 995 F.2d at 1279, that a debtor cannot "classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan." The *Tucson Self-Storage* court held that, absent a business or economic justification, separate classification of unsecured claims solely on their right to make a § 1111(b)(2) election is an impermissible classification in violation of § 1122(a). 166 B.R. at 897-99; *see also Montclair Retail Ctr. L.P. v. Bank of the West* (*In re Montclair Retail Ctr.*), 177 B.R. 663, 665-66 (BAP 9th Cir. 1995) (following *Tucson Self-Storage*). We agree with the principles enunciated in the *Greystone III* line of cases, that is, absent legitimate business or economic justification, it is impermissible for Debtor to classify LICV's deficiency claim separately from general unsecured claims.

Debtor also cites *In re Johnston*, 21 F.3d at 327, in support of its position. In *Johnston*, the court concluded that separate classification of unsecured creditors may be justified "where the legal character of their claims is such as to accord them a status different from other unsecured creditors." *Id.* at 328 (*quoting In re Los Angeles Land and Invs.*, 282 F.Supp. 448, 453-54). *Johnston*, however, is distinguishable. The court found that the creditor in *Johnston* was embroiled in litigation with the debtor regarding issues unrelated to the bankruptcy, that, if successful, would have fully paid the creditor's claim before all other unsecured creditors. *Id.* Further, the creditor's claim was potentially exceeded by the debtor's own claim against

the creditor and subject to offset. *Id.* Finally, the creditor's claim was partially secured by a security interest in other property. *Id.* at 326. Thus, the court concluded, the bankruptcy court did not clearly err in finding that the creditor held a different legal status from that of the other unsecured claimants. *Id.* at 328. In this case, these special circumstances do not exist. The claim at issue here is simply a legally created recourse debt. The bankruptcy court found that Debtor offered no business or economic justification for the separate classification of such a deficiency claim. The sole purpose of Debtor's separate classification was to obtain acceptance of the Plan. The bankruptcy court did not err in its finding that the claims were similar and that separate classification was not permitted.[9]

B. *Security Deposit Creditors*

Debtor divided the tenants' pre-petition security deposits into two classes. Class 2 consisted of 51 tenants with priority claims for up to $900 per tenant. ER at 68-69. The statute provides a priority for claims to the extent of $900 held by individuals who have made deposits with the debtor "in connection with the purchase, lease, or rental of property." 11 U.S.C. § 507(a)(6). Class 4 consisted of 18 tenants with claims for the non-

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[9] Debtor argues that the Bankruptcy Judge incorrectly determined that it was obligated to follow the BAP's holding in *Tucson Self-Storage*. The BAP's precedent-setting power is a subject of great debate. As we affirm the district court and the bankruptcy court on the merits, we decline to decide the authoritative effect of *Tucson Self-Storage*.

priority portion of the pre-petition security deposits which were not due and owing at the time the Plan was submitted. ER at 69.

Under the Plan, Debtor proposed to deposit the entire amount of the Class 2 claims into a Priority Tenant Deposit Account on the effective date or as soon thereafter as practicable. Debtor would pay these claims "as such claims come due from the Operating Account or (if such funds are on deposit) the Priority Tenant Deposit Account." ER at 70. Class 4 claimants would be paid as such payments "become due under state law." ER at 77.

As a threshold matter, appellee argues that the separate classification by Debtor of the Class 4 unsecured tenant deposit claims violates § 1122. Appellee raised this objection before the bankruptcy court, but neither the bankruptcy court nor the district court addressed the classification issue. It appears that both courts assumed that separate classification was proper. In any event, we find that the bankruptcy court did not err in separately classifying this class. The likely basis for the separate classification, as contended by Debtor below, was that such claims were legally different from the other unsecured claims. Under state law, the security deposit claims were not yet due. *See Federated Mortgage Investors v. American Sav. & Loan Assoc. of Cal.*, 47 Cal.App.3d 917, 121 Cal.Rptr. 137, 142-43 (1975). Moreover, such claims were both contingent and unliquidated, as each claim would become due only when and if the tenant vacates, and then only to the extent that rent is paid up through the date of vacation and the premises are left in the required condition. *Id.* Also, such tenants typically have state law remedies for an accounting of any disposition of

a security deposit, return of the security deposit after lawful deductions have been made, or compensatory and punitive sanctions against a landlord for nonpayment of the security deposit. *See* Cal. Civ.Code § 1950.5 (West 1995). Thus, separate classification of this class of claims was appropriate.

Both the bankruptcy court and the district court found that the Class 2 and Class 4 security deposit creditors were not "impaired" under § 1124. A class of claims is impaired under a plan unless, with respect to each claim, the plan:

> (1) leaves unaltered the legal, equitable, and contractual rights to which such claim . . . entitles the holder of such claim . . . ; or
>
> . . . .
>
> (3) provides that, on the effective date of the plan, the holder of such claim . . . receives, on account of such claim . . . cash equal to . . .
>
> (a) the allowed amount of such claim. . . .

11 U.S.C. § 1124(*l*), (3)(a). Congress intended to define impairment broadly, and, generally, any alteration of a creditor's legal rights constitutes impairment. *L & J Anaheim Assocs. v. Kawasaki Leasing Int'l Inc.* (In re Anaheim Assocs.), 995 F.2d 940, 942-43 (9th Cir.1993). A class that is not impaired is "conclusively presumed to have accepted the plan." 11 U.S.C. § 1126(f).

Under § 1129(a)(9)(B), a class with priority claims under § 507(a)(6), such as Class 2, may receive,

> (i) if such class has accepted the plan, deferred cash payments of a value, as of the

> effective date of the plan, equal to the allowed amount of such claim; or
>
> (ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim;. . . .

11 U.S.C. § 1129(a)(9)(B). As to Class 2, the district court concluded that Debtor's Plan satisfied these criteria, and Class 2 claimants were unimpaired under the Plan. ER at 229. As to Class 4, the district court determined that the tenants' claims were also "unaltered" because the Plan proposed to pay the tenants their security deposits as they became due, i.e., when the tenants vacated the premises. ER at 229.

Debtor argues that the security deposit creditors were impaired under the Plan. According to Debtor, Article XII of the Plan proposes to discharge, following confirmation of the Plan, the Class 2 and Class 4 claims if Debtor defaults on payment and, in that event, to preclude state law remedies of the Class 2 and Class 4 creditors. Further, the Plan proposes that Class 2 creditors will be paid as their claims become due under state law, but only to the extent that such funds are available through the Priority Tenant Deposit Account established from the net revenues of the Kittridge property. According to Debtor, if the Kittridge property operates at a loss, no funds would be deposited into the Priority Tenant Deposit Account, resulting in insufficient assets to pay the Class 2 claimants. This appears to conflict with the Plan's proposed provision requiring the entire amount of the allowed Class 2 claims to be deposited into the Priority Tenant Deposit Account on the effective date of the Plan or soon thereafter. ER at 76. Finally, Debtor asserts

that the other possible basis for finding a class to be "unimpaired" – payment in full on the effective date of the Plan – is inapplicable, as the Plan does not propose to pay in full in cash the Class 2 and Class 4 claims on the effective date. Based on the foregoing, Debtor contends, the Class 2 and Class 4 creditors were "impaired" because their legal, equitable, and contractual rights were changed under the Plan. We disagree.

We affirm the lower courts' rulings that the Class 2 and Class 4 were not impaired classes eligible to vote on the Plan, albeit on a somewhat different basis. The Class 2 and Class 4 tenant security deposit claimants could not constitute a voting class for purposes of effecting a cram-down. Tenant security depositors, where the debtor assumes the lease, as in the instant case,[10] "have no provable claim against the bankruptcy estate." *Boston Post Rd.*, 21 F.3d at 484; *Greystone III*, 995 F.2d at 1281 ("A party to a lease is considered a 'creditor' who is allowed to vote [under] 11 U.S.C. § 1126(c), only when the party has a claim against the estate that arises from *rejection* of a lease."). The obligations assumed by the debtor under the continued leases constitute post-petition administrative claims under § 503(b)(1)(A) and are entitled to priority under § 507(a)(1). *Boston Post Rd.*, 21 F.3d at 484. Their holders are not entitled to vote on a plan of reorganization as they are entitled to be paid in full, pursuant to 11

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[10] The Plan provides that "[a]ll pre-petition executory contracts to which Debtor is a party which have not been assumed or rejected prior to the Effective Date shall be deemed assumed as of the Effective Date, pursuant to 11 U.S.C. § 365. These executory contracts include all leases with tenants. . . . " ER at 84.

U.S.C. § 1129(a)(9)(A). *Id.; Greystone III,* 995 F.2d at 1281. Thus, the Class 2 and Class 4 claimants were not entitled to vote on Debtor's Plan. We affirm the district court's finding that no impaired class existed to vote for confirmation of the Plan.

C. *Unsecured Trade Creditors*

Debtor also separately classified the pre-petition claims of trade creditors (Class 6) from general unsecured claims. Under the Plan, trade creditors were creditors who continued to do business with Debtor after Debtor filed for Chapter 11 protection. ER at 73. These creditors provided such services as trash collection, pool maintenance, roof repair, etc. ER at 210. The bankruptcy court found it impermissible to separately classify these creditors. *Id.*

Debtor argues that separate classification is justified because trade creditors expect to earn profits from future dealings with Debtor. The bankruptcy court noted, however, that "literally thousands of companies are available to provide the [ ] services" of the trade creditors, thus none of the trade creditors were essential to Debtor's continued maintenance of the apartment building. ER at 210; *see Boston Post Rd.,* 21 F.3d at 483 (no valid justification for separate classification of trade creditors that were few and not essential to debtor's future). The factual basis of the bankruptcy court's decisions is not challenged and there is no legal distinction between the trade creditor claims and the general unsecured claims that

would justify separate classification.[11] The bankruptcy court did not err.

CONCLUSION

Debtor's Plan of Reorganization was properly denied confirmation for lack of the assent of an impaired non-insider class of creditors. LICV's unsecured deficiency claim and the unsecured trade creditors do not qualify as such a class; they were segregated from like unsecured creditors without any demonstrated legitimate reason. Nor do the tenant security deposit creditors qualify as such a class; as holders of administrative claims entitled to be paid in full as priority claimants, they were not entitled to vote on the Plan of Reorganization. In sum, we AFFIRM the district court.

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[11] We need not reach the issue of whether Debtor's Plan of Reorganization violates the absolute priority rule.

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re: MOHAMMAD SAMIH BARAKAT, Debtor.	
MOHAMMAD SAMIH BARAKAT, Appellant, v. THE LIFE INSURANCE COMPANY OF VIRGINIA, Appellee.	No. 95-55709 D.C. Nos. CV-94-6462-JGD CV-94-6463-JGD ORDER (Filed Dec. 30, 1996)

Before: FLETCHER and TASHIMA, Circuit Judges, and RESTANI,* United States Court of International Trade Judge.

Appellant's motion to stay the mandate is granted for 30 days from the date of this order. Federal Rule of Appellate Procedure 41(b) governs. All terms of stay of the district court shall continue in effect.

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* Honorable Jane A. Restani, United States Court of International Trade Judge, sitting by designation.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: MOHAMMAD SAMIH BARAKAT, Debtor.	No. 95-55709 D.C. #CV 94-6462-JGD #CV 9406463-JGD [sic]
MOHAMMAD SAMIH BARAKAT, Appellant, v. THE LIFE INSURANCE COMPANY OF VIRGINIA, Appellee.	ORDER (Filed Dec. 19, 1996)

Before: FLETCHER and TASHIMA, Circuit Judges, and RESTANI*

The panel as constituted in the above case has voted to deny the petition for rehearing. Judge Fletcher and Tashima voted to reject the suggestion for rehearing en banc and Judge Restani so recommends.

The full court has been advised of the suggestion for rehearing en banc and no judge of the court has requested a vote on it. Fed. R. App. P. 35(b).

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

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* Honorable Jane A. Restani, Judge, United States Court of International Trade, sitting by designation.

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re: MOHAMMAD SAMIH BARAKAT, Debtor.	
MOHAMMAD SAMIH BARAKAT, Appellant, v. THE LIFE INSURANCE COMPANY OF VIRGINIA, Appellee.	No. 95-55709 DC# CV-94-06462-JGD Central California (Los Angeles) ORDER (Filed Oct. 12, 1995)

This case is released from the Settlement Program.

FOR THE COURT:

/s/ David E. Lombardi, Jr.
David E. Lombardi, Jr.
Chief Court Mediator

10/10/95:blsp

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: MOHAMMAD SAMIH BARAKAT, Debtor.	
MOHAMMAD SAMIH BARAKAT, Appellant, v. THE LIFE INSURANCE COMPANY OF VIRGINIA, Appellee.	No. **95-55709** DC# CV-94-06462-JGD Central California (Los Angeles) ORDER (Filed Aug. 8, 1995)

The court will hold an in-person settlement conference in this matter at 9:30 a.m., October 6, 1995, at the U.S. Court of Appeals Building, 125 South Grand Avenue, Mural Room, Pasadena, California.

Unless excused by the Court Mediator the following shall attend with *full discretionary settlement authority*: attorneys for the parties, Mohammad Samih Barakat and an officer of The Life Insurance Company of Virginia. Participants should plan to spend the entire day, if necessary, engaged in meaningful settlement discussions. Counsel shall inform the conference secretary [fax: (415) 744-9725] of the exact names, addresses and telephone numbers of participants.

Mediation statements of no more than 10 pages in length shall be sent to the Court Mediator [fax no. (415)

744-9725] by 5:00 p.m. October 3, 1995, but shall *not* be sent to the opposing party. The mediation statements shall include a concise statement of the facts, a brief summary of the issues and arguments, a statement [sic] *both* parties' underlying interests (so far as known), and a statement of the obstacles to settlement so far and proposals for overcoming them.

FOR THE COURT:

/s/ David E. Lombardi, Jr.
David E. Lombardi, Jr.
Chief Court Mediator

8/3/95:rs

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re: MOHAMMAD SAMIH BARAKAT, Debtor.	
MOHAMMAD SAMIH BARAKAT, Appellant, v. THE LIFE INSURANCE COMPANY OF VIRGINIA, Appellee.	No. 95-55709 DC# CV-94-06462-JGD Central California (Los Angeles) ORDER (Filed Jul. 5, 1995)

The assessment conference previously scheduled for July 11, 1995, is postponed to August 1, 1995 at 11:00 a.m. Pacific Time. The court will initiate the conference call.

FOR THE COURT:

/s/ David E. Lombardi, Jr.
David E. Lombardi, Jr.
Chief Court Mediator

6/29/95:blsp

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: MOHAMMAD SAMIH BARAKAT, Debtor.	No. **95-55709**
MOHAMMAD SAMIH BARAKAT, Appellant, v. THE LIFE INSURANCE COMPANY OF VIRGINIA, Appellee.	**ORDER SETTING ASSESSMENT CONFERENCE** (Filed Jun. 23, 1995) DATE: **July 11, 1995** TIME: **03:00 pm**

This case is under consideration for inclusion in the Settlement Program. *See* Fed. R. App. P. 33 and Ninth Cir. R. 33-1. Unless otherwise ordered by the court, a settlement assessment conference will be held on **July 11, 1995 at 03:00 pm PACIFIC TIME.** The conference will be held by telephone unless counsel agree and notify the Settlement Program.

General questions about the Program and its procedures should be directed to the Settlement Program in San Francisco at (415) 744-9900 or by fax number (415) 744-9725. Correspondence may be sent to the U.S. Court of Appeals, Settlement Program, P.O. Box 193939, San Francisco, California, 94119-3939. All correspondence must include the Ninth Circuit docket number.

The court will initiate the telephone call and contact each participant at the telephone number listed below

under "CONFERENCE PARTICIPANTS." Check the information shown below for completeness and accuracy. Please advise the Settlement Program of any changes or corrections in participants or telephone numbers by telefax or letter.

PURPOSE AND PROCEDURES

The primary purpose of the settlement assessment conference is to discuss the litigation history and determine whether the case should be included in the court's Settlement Program. Counsel should discuss settlement with their principals before the conference. The initial conference typically lasts about 30 minutes.

Please notify the Settlement Program by telefax or letter in advance of the conference if the case settles or is otherwise resolved.

The content of all settlement discussions before the Ninth Circuit Court of Appeals shall remain confidential and shall not be disclosed by the Court Mediator nor by counsel in briefs or arguments.

WHO SHOULD ATTEND

All counsel intending to file briefs in the case shall attend the conference. If more than one attorney is representing a party, then the attorney with the most direct relationship with the client for the purpose of settlement discussions must attend. Co-counsel and other attorneys in principal counsel's firm may attend if their presence would be beneficial.

The counsel designated below are understood to be the lawyers with primary responsibility for the case. If different or additional attorneys should be on the list, advise the Settlement Program by telefax or letter as described above.

Clients generally do not participate in the assessment conference. If all parties agree that they want clients at the conference, please notify the Settlement Program by telefax or letter as described above.

BRIEFING SCHEDULE

The existing briefing schedule remains in effect.

REQUESTS TO RESCHEDULE THE CONFERENCE

Counsel with a directly conflicting court date or a planned vacation may request to alter the date of the conference.

Notify the Settlement Program of the need to reschedule by telefax or letter along with three alternative dates and times that are acceptable to the other conference participants.

FOR THE COURT:

/s/ Beatriz L. Smith-Patrick
Beatriz L. Smith-Patrick
Deputy Clerk

6/21/95:blsp-DEL

MARK T. YOUNG (Bar No. 89951) and
MARC A. LIEBERMAN (Bar No. 157318) of
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Attorneys for Debtor/Appellant,
MOHAMMAD SAMIH BARAKAT

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

In re: MOHAMMAD SAMIH BARAKAT, an individual, Debtor.	Case Nos. CV 94-6462-JGD and CV 94-6463-JGD Bankruptcy Court Case No. LA 93-47514-GM [Chapter 11]
THE LIFE INSURANCE COMPANY OF VIRGINIA, Movant, vs. MOHAMMAD SAMIH BARAKAT, Respondent.	Ref. No. MO 93-02964-GM ORDER GRANTING STAY PENDING APPEAL (Filed Apr. 24, 1995) [No Hearing Set]

The Court having reviewed the "Ex Parte Application for Stay Pending Appeal of 'Memorandum Opinion Affirming Bankruptcy Court's August 15, 1994 and August 16, 1994 orders' " filed herein by Debtor/Appellant MOHAMMAD SAMIH BARAKAT, and good cause therefore appearing, IT IS HEREBY ORDERED that the Ex

Parte Application is granted on the conditions stated in this Order. Specifically, the "Memorandum Opinion Affirming Bankruptcy Court's August 15, 1994 and August 16, 1994 Orders" entered herein on April 13, 1995 is hereby STAYED pending the appeal of the Memorandum Opinion to the United States Court of Appeals for the Ninth Circuit, subject to the following terms and conditions:

1. Debtor shall bring and remain current on all property taxes due on the subject real property (14420 Kittridge Street, Van Nuys, California 91405) ("the Property").

2. Debtor shall maintain insurance on the Property as such insurance was maintained as of September 1, 1994, and will add LICV as a loss payee to any additional or renewed insurance on the Property.

3. Debtor shall maintain the condition of the Property as it existed as of September 1, 1994. Debtor shall not defer expenses which are required to maintain the condition of the Property.

4. Debtor shall make monthly payments to LICV in the sum of $27,500. Such payments represent interest payments at 11% per annum on the secured portion of the debt to LICV, based on an estimated value of the Property of $3,000,000. Such monthly payments are due by the tenth (10th) day of each month, commencing on September 10, 1994. Such payments may be made from the rents, issues, and profits generated by the Property ("the Rents").

5. Debtor is authorized to pay from the Rents the Budgeted Expenses enumerated in the prior Stipulation re Cash Collateral with LICV. Debtor is not required to seek LICV's approval to pay any such Budgeted Expenses.

6. Debtor is authorized to pay from the Rents usual and customary monthly management fees for management of the Property, subject to the right of LICV to object to payment of such fees.

7. Debtor shall not pay from the Rents any expense other than payments to LICV (as described in Paragraph 4 hereinabove), the Budgeted Expenses (as described in Paragraph 5 hereinabove), and management fees (as described in Paragraph 6 hereinabove), without the prior written approval of LICV, or an order of this Court.

8. In the event that Debtor does not have enough funds to pay the required monthly payment to LICV and the Budgeted Expenses, Debtor must make up the deficit from non-estate sources in order to pay such amounts as they become due.

9. In the event that Debtor has excess funds after payment to LICV, payment of the Budgeted Expenses, and payment of management fees, all such funds shall be deposited into Debtor's debtor-in-possession account.

10. In the event of a default under any of the terms of this Order, LICV may provide written notice of the default to Debtor and his counsel via facsimile. If the default is not cured or if Debtor has not obtained an Order from the Bankruptcy Court regarding the non-existence of the asserted default within ten (10) days after

the Order is received by facsimile, LICV will be entitled to conduct a foreclosure sale of the Property.

Dated: Apr. 24, 1995

John G. Davies
JOHN G. DAVIES
United States
District Judge

Presented By:

MAYER, GLASSMAN & GAINES

By: /s/ Mark T. Young
MARK T. YOUNG
Attorneys for Debtor/Appellant,
MOHAMMAD SAMIH BARAKAT

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

In re: MOHAMMAD SAMIH BARAKAT, Debtor.	CASE NO. CV 94-6462 JGD CASE NO. CV 94-6463 JGD
THE LIFE INSURANCE COMPANY OF VIRGINIA, Plaintiff-Appellee v. MOHAMMAD SAMIH BARAKAT, Defendant-Appellant.	MEMORANDUM OPINION AFFIRMING BANKRUPTCY COURT'S AUGUST 15, 1994 AND AUGUST 16, 1994 ORDERS (Filed Apr. 10, 1995)

Debtor-Appellant Mohammed [sic] S. Barakat sought confirmation of a Plan of Reorganization filed under Chapter 11 of the Bankruptcy Code. The Bankruptcy Court denied confirmation of the Plan, finding that it was impermissible for the Plan to (1) separately classify the unsecured deficiency claim and the general unsecured creditors; (2) separately classify trade creditors and other unsecured creditors; and (3) identify security deposit creditors as an impaired class. The result was no impaired class that would vote to accept the Plan. The Plan was thus rejected under 11 U.S.C. § 1129(a)(10), and the court granted relief from the automatic stay. The Debtor challenges the Bankruptcy Court's findings. This Court affirms.

I. FACTS

Kittridge Garden Associates ("KGA"), a California general partnership, owned and managed an 85-unit, three-story residential apartment building located at 14420 Kittridge Street, Van Nuys, California (the "property"). On August 25, 1988, KGA executed a promissory note in favor of the Life Insurance Company of Virginia ("LICV"). The note was secured by a first deed of trust on the property. The promissory note was in the principal sum of $4,550,000, with an annual interest rate of 9.625%.

On May 9, 1989, KGA conveyed all of its rights in the property to Mohammed Barakat and four relatives (the "Barakat group").[1] The grant deed was recorded on May 17, 1989. The Barakat group paid $2,470,000 in cash, and assumed KGA's obligations under the promissory note. At that time, the balance of the promissory note was $4,410,000.

The Barakat group made all payments on the note until June, 1993. On June 13, 1993, three of the five members of the Barakat group conveyed title to the property to Debtor and his wife.[2] Debtor thereafter defaulted on the payments to LICV. Debtor and LICV attempted to restructure the promissory note. They could not reach an agreement, and LICV sought judicial foreclosure and the appointment of a receiver. On October 22, 1993, Debtor

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[1] The Barakat group included Adil Barakat and Rihab Barakat, husband and wife, Siham Barakat, Debtor's wife, and Nabil Y. Barakat.

[2] The quitclaim deed was recorded on August 16, 1993.

filed for relief under Chapter 11 of the Bankruptcy Code, thereby staying LICV's foreclosure action.

As of the date of the Debtor's petition, the only secured claim against the property was held by LICV. According to the Debtor, he owed LICV $4,540,088.36 under the promissory note. The property was valued at $3,970,000.

On November 17, 1993, LICV filed a motion seeking relief from the automatic stay. The motion was heard on December 23, 1993, and on January 13, 1994, the Bankruptcy Court modified the automatic stay and allowed LICV to proceed with a non-judicial foreclosure. The Bankruptcy Court denied LICV's request to appoint a receiver. The motion for relief from the stay was continued to February 22, 1994. On that date, the Bankruptcy Court was scheduled to conditionally approve Debtor's disclosure statement. Thereafter, LICV's motion for relief from the stay moved forward simultaneously with the Bankruptcy Court's hearing to approve the disclosure statement.

The disclosure statement hearing was continued to May 17, 1994, because of earthquake damage to the office of Debtor's counsel. Debtor retained new counsel who filed an extensive disclosure statement on April 14, 1994. At the May 17, 1994 hearing, Debtor withdrew the disclosure statement and the Bankruptcy Court continued the hearing to July 12, 1994.

On June 20, 1994, Debtor filed an amended disclosure statement and plan of reorganization. The disclosure statement provided for reduction of LICV's secured claim to $3,970,000, the fair market value of the property. LICV

held a deficiency claim that was separately classified. The plan proposed the following seven classes:

Class 1, LICV's secured claim in the amount of $3,970,000 (secured by the property);

Class 2, priority claims for individual tenant pre-petition security deposits to the extent of $900 per tenant. The class consisted of 51 claimants and $29,960 in claims. The claims were entitled to priority under Section 507(a)(6) of the Bankruptcy Code;

Class 3, LICV's unsecured deficiency claim (the unsecured portion of the LICV note, also defined as the difference between the amount owed under the LICV note as of the commencement date and the Class 1 claim). The amount of the deficiency claim was $570,088.36;

Class 4, non-priority claims of tenants for pre-petition security deposits. The class consisted of eighteen claimants, and $3,805 in claims;

Class 5, general unsecured claims that were not separately classified. The class consisted of ten claimants, and total claims of $21,616.22;

Class 6, general unsecured claims held by creditors who continued to do business with Debtor after Debtor filed his petition. These creditors have an ongoing business relationship with Debtor. The class consisted of thirteen claimants, and total claims of $20,434;

Class 7, general unsecured claims held by insiders of Debtor. The class consisted of two claimants, and total claims of $29,516.31.

The Bankruptcy Court identified the following problems with the plan. First, there was no justification for separately classifying ongoing trade creditors and other unsecured creditors. Second, LICV's deficiency claim should be part of the general unsecured class. Third, under the plan, the security deposit creditors were not impaired. The hearing was continued to allow the Debtor to correct these problems and amend the proposed disclosure statement.

On August 2, 1994, Debtor filed a Second Amended Plan of Reorganization (the "Plan") and Second Amended Disclosure Statement. On August 9, 1994, the Bankruptcy Court reviewed the Plan and found that the only change made was the Debtor's relatives would contribute $50,000 in cash. Plan at 8.

LICV challenged the Plan on several grounds. Specifically, LICV objected to (1) separate classification of the deficiency claim (Class 3); (2) Class 2 and Class 4, consisting of tenants who have a claim to security deposits, being classified as "impaired"; (3) the interest rate on the secured claim that did not provide LICV with the present value of its claim as required under Section 1129(b)(2)(A); and (4) the Plan's violation of the absolute priority rule.

The Bankruptcy Court found that it was bound by the Bankruptcy Appellate Panel's (BAP) decision in *In re Tucson Self-Storage*, 166 B.R. 892 (9th Cir. BAP 1994), and that it was impermissible to separately classify LICV's deficiency claim and the general unsecured class. Further, there was no justification for separately classifying ongoing trade creditors and general unsecured creditors. In light of these rulings, confirmation of the plan would

require the general unsecured creditors to accept the Plan under the cram down provisions of Section 1129(b). LICV would hold the largest unsecured claim and, under Section 1126(c), it would have to accept the Plan for the Plan to be approved. LICV would not accept the Plan because it sought to protect its secured claim. Since no impaired accepting class existed, other than insiders who have no authority to vote to accept the Plan, the Code requirements for Plan acceptance were not satisfied. The Plan could not obtain the vote of a legitimately impaired class of non-insider creditors as required by Section 1129(a)(10).

On August 15, 1994, the Bankruptcy Court granted LICV's Motion for Relief from the Automatic Stay, and on August 16, 1994, the Bankruptcy Court issued the Order Denying Approval of Debtor's Second Amended Disclosure Statement. Debtor appeals from each order. Because relief from the automatic stay was granted when the Plan could not be approved, the issues on appeal from each of said orders are identical. On September 1, 1994, the Court granted the Debtor's motion for a stay pending appeal.

II. ISSUES ON APPEAL

The following issues are before the Court: (1) whether the Bankruptcy Court was bound by the BAP's decision in *Tucson Self-Storage*; (2) whether separate classification of LICV's deficiency claim is permissible absent a legitimate business justification for separate classification; (3) whether the claims for pre-petition security deposits were impaired under the Plan; and (4) whether it

was permissible to separately classify trade creditors' claims and general unsecured creditors' claims.

III. STANDARD OF REVIEW

This Court has jurisdiction, pursuant to 28 U.S.C. § 158(a), to hear an appeal from a final judgment in a bankruptcy court. As an appellate court, the district court should apply the clearly erroneous standard to findings of fact by the bankruptcy court. Bankruptcy Rule 8013. A finding is clearly erroneous when, although there is evidence to support it, the court finds on the record before it that a mistake has been made. *In re Arnold*, 908 F.2d 52 (6th Cir. 1990). The bankruptcy court's conclusions of law are reviewed *de novo*. *In re A&C Properties*, 784 F.2d 1377, 1380 (9th Cir. 1986).

IV. DISCUSSION OF ISSUES

A. Stare Decisis Effect of the BAP

The Bankruptcy Judge found that under *In re Tucson Self-Storage*, 166 B.R. 892 (9th Cir. BAP 1994), it was impermissible for the Debtor to separately classify LICV's deficiency claim and general unsecured claims. The Bankruptcy Judge stated that if a BAP opinion on point did not exist, she would have allowed the separate classification. In *Tucson Self-Storage*, the BAP held that absent a business or economic justification, it is impermissible to classify deficiency claims separately from general unsecured claims. *Id.* at 897. The question is whether the Bankruptcy Judge was obligated to follow the BAP's holding.

In the Ninth Circuit, appeals from the Bankruptcy Court may be routed to the BAP or the district court. The BAP consists of rotating panels of three Article I bankruptcy judges from within the circuit but outside the district from which the appeal arises. Although appeals are ordinarily to the BAP, either party has the right to opt out of the BAP and remove the appeal to the district court.

Debtor argues that the Bankruptcy Court erred in finding that it was bound by the BAP's decision in *Tucson Self-Storage*. The argument is as follows. The BAP, and the district court sitting in its appellate capacity, sit at the same intermediate appellate level. The BAP sits "in lieu of" the district court, and its precedent-setting power is limited to that of the district court in lieu of which it sits. Since the district court has no power to bind courts not in its district, the BAP also has no authority to bind the entire circuit. *Tucson Self-Storage* arose in a Bankruptcy Court in the District of Arizona. It thus is not binding upon a Bankruptcy Court sitting in the Central District.

The BAP's precedent-setting power has not been decided by the Ninth Circuit, and is widely debated. *See* Daniel J. Bussel, *Power, Authority, and Precedent in Interpreting the Bankruptcy Code*, 41 **UCLA L. Rev.** 1063 (1994).

The Bankruptcy Court explained in detail the reasons it felt bound by the BAP. It found that if bankruptcy court decisions could only be appealed to the BAP, i.e. if there was no right to appeal to the district court, the BAP would bind bankruptcy courts throughout the circuit. The fact that an alternative appeal to the district court exists should not affect the stare decisis affect of BAP decisions.

This is true despite the fact that district courts sitting in their appellate capacity have no authority to bind courts in other districts or even district courts in the same district.

This Court agrees with the conclusion reached by the Bankruptcy Court. The purpose of the BAP is to enhance the uniformity and predictability of bankruptcy law. The BAP consists of bankruptcy judges with specialized knowledge. These judges are likely to contribute more to the development of bankruptcy law than are district judges who have limited experience with bankruptcy matters. Thus, it would be preferable to route all appeals from bankruptcy courts to the BAP, and thereby encourage development of uniform bankruptcy law. The fact that the present system allows for appeals to the district court is no reason to reduce the precedent-setting ability of the BAP.

Bankruptcy courts adjudicate core bankruptcy matters. But they ought to be controlled, as all trial courts are, by the obligation to defer to the law established by the appellate courts which review their decisions. It is unlikely that Congress established the BAP to review decisions by bankruptcy courts without providing the BAP with the authority to bind lower bankruptcy courts. Unless bankruptcy courts are bound to follow the rules announced by appellate courts, the function of the BAP would be solely to correct errors in individual cases. Deploying expert bankruptcy judges to perform this task, and establishing an appellate system with no authority to clarify the law, is likely not what Congress intended.

This Court finds that the Bankruptcy Court correctly found that it was bound by the BAP's decision.

B. Separate Classification of the Deficiency Claim

The Bankruptcy Court denied confirmation of the Plan. It found that under *Tucson Self-Storage*, the Plan could not separately classify LICV's unsecured deficiency claim and other unsecured claims. At issue on appeal is whether the Debtor was entitled, or required, to separately classify the deficiency claim. Although the Bankruptcy Court stated it would have found that separate classification was required if it had not been bound by *Tucson Self-Storage*, classification issues are questions of fact subject to considerable discretion by the Bankruptcy Judge. *In re Johnston*, 21 F.3d 323, 327 (9th Cir. 1994). The Court thus reviews the Bankruptcy Court's finding that separate classification was impermissible for clear error.

The classification of claims is important in determining whether a Chapter 11 plan of reorganization may be confirmed. Under Section 1129(a), the Bankruptcy Court may confirm the plan if each class of impaired claims accepts the plan, 11 U.S.C. § 1129(a)(8), or at least one class of claims that is impaired under the plan accepts the plan, "without including any acceptance of the plan by any insider." 11 U.S.C. § 1129(a)(10). Section 1129(a)(10) provides for a "cram down" procedure. The debtor may cram down the plan provided it is fair and equitable and does not unfairly discriminate against any impaired claims, Section 1129(b), and the plan meets all the statutory requirements of Section 1129(a).

Where, as here, a secured creditor has a claim against the debtor that exceeds the value of the collateral, Sections 506(a) and 1111(b) of the Bankruptcy Code are implicated. Under these sections, a partially secured claim is bifurcated into two claims: a secured claim, equal to the value of the collateral, and an unsecured claim for the deficiency. The value of the deficiency claim is the difference between the creditor's claim and the value of the property. Under Section 1111(b)(2), the creditor may elect to have the claim allowed as a secured claim for the full contractual amount rather than the amount of the collateral's value. LICV chose not to elect to invoke Section 1111(b)(2).

Under the Plan, the Debtor separately classified the unsecured deficiency claim and the other unsecured claims. The purpose of separate classification was to create an impaired class that would accept the plan. If LICV's deficiency claim were classified with other unsecured claims, the Plan could not be accepted so long as LICV objected. LICV's deficiency claim far exceeds any of the other unsecured claims. For a class to accept a plan, the holders of a majority in number and two-thirds in amount must approve the plan. Section 1126(c). LICV was not likely to accept the Plan because it sought to protect its secured claim.

1. Classification of Claims

A plan may place a claim in a particular class "only if such claim or interest is substantially similar to the other claims or interests of such class." Section 1122(a). While dissimilar claims may not be put in the same class, the

Code does not address whether the plan may separately classify similar claims, or whether it must classify similar claims together. Bankruptcy courts and appellate courts disagree on this issue.

Here, Debtor argues that the LICV deficiency claim differs from other unsecured claims because it is an artificial claim created by Section 1111(b). Debtor further argues that LICV's economic interest in the reorganization differs from that of other unsecured creditors. LICV seeks to protect its secured claim, and should not be allowed to utilize its unsecured deficiency claim to reject the plan, obtain relief from the automatic stay, and foreclose on the property.

In *In the Matter of Woodbrook Assoc.*, 19 F.3d 312, 318 (7th Cir. 1994), the Seventh Circuit held that the holder of a Section 1111(b) claim has a significantly different claim than a general unsecured creditor. Separate classification is therefore required. The holder, who also has a secured claim, will be uniquely affected by the treatment of the secured claim. Thus, under Section 1122(a) the claims may not be classified together. *Id.*

In *In re Boston Post Road*, 21 F.3d 477 (2nd Cir. 1994), the Second Circuit reached the opposite result. The *Boston Post Road* court held that separate classification for the purpose of preventing the under-secured creditor from rejecting the plan is contrary to the principles underlying the Bankruptcy Code. Creditors holding greater debt should have a comparably greater voice in reorganization. *Id.* at 483. The court acknowledged that prohibiting the debtor from separately classifying deficiency claims will effectively bar single asset debtors from utilizing the

Code's cram down provisions. The court, however, was not persuaded that a single-asset debtor should be able to cram down a plan that disadvantages the largest creditor. Absent a legitimate reason, separate classification is not permitted. *Id.*

The position taken by the *Boston Post Road* court is shared by the majority of jurisdictions. *See e.g. In re Lumber Exchange Building Ltd. Partnership,* 968 F.2d 647 (8th Cir. 1992); *Greystone III,* 995 F.2d 1274 (5th Cir. 1991). Further, the BAP recently adopted this position in *In re Tucson Self-Storage,* 166 B.R. 892 (9th Cir. BAP 1994). In *Tucson Self-Storage,* the BAP held that separate classification based solely on the deficiency claim holder's right to elect to fully secure the claim violates Section 1122(a). *Id.* at 897. Unless similar claims are kept together, nothing prevents the debtor from seeking out a few impaired creditors who will vote for the plan and placing them in their own class. *Id.*, citing *In re U.S. Truck Co.,* 800 F.2d 581, 586 (6th Cir. 1986). The court reversed the bankruptcy court's confirmation of the plan because there was no business or economic justification for classifying the deficiency claim separately from claims of other unsecured creditors. The sole purpose of the separate classification was to gerrymander an affirmative vote of an impaired class. *Id.* at 898.

When the debtor attempts to satisfy the requirement of Section 1129(a)(10), i.e. create an impaired class that will accept the plan, most courts agree that separate classification of similar claims is impermissible. *See e.g. In re Bryson Properties XVIII,* 961 F.2d 496 (4th Cir. 1992). As the Fifth Circuit has said:

> [There is] one clear rule that emerges from otherwise muddled caselaw on § 1122 claims classification: thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan.

Greystone III, 995 F.2d at 1279.

2. Separate Classification Was Impermissible

The Court is persuaded by *Tucson Self-Storage* and the cases holding that it is impermissible to classify deficiency claims separately from general unsecured claims. The Bankruptcy Court found that the Debtor had no business or economic justification for separately classifying the deficiency claim. Memorandum of Opinion at 5. This finding was not clearly erroneous. The Debtor's motivation was to satisfy the requirement of Section 1129(a)(10) that there be an accepting impaired class. To permit separate classification in such situations would prevent creditors holding greater debt from having a greater voice in the reorganization plan. *Boston Post Road*, 21 F.3d at 483. The Debtor cannot separately classify claims for the sole purpose of obtaining acceptance of the Plan. The Bankruptcy Court correctly found that it was impermissible for Debtor to classify the deficiency claim separately from general unsecured claims.

C. Residential Security Deposits

The Debtor divided tenants' pre-petition security deposits into two classes. Class 2 consisted of 51 tenants who have a priority claim for up to $900. Section 507(a)(6)

of the Code provides a priority for claims up to $900 held by individuals who have made deposits with the debtor "in connection with the purchase, lease, or rental of property." 11 U.S.C. § 507(a)(6).[3] Class 4 consisted of 18 tenants with claims for the non-priority portion of the prepetition security deposits which were not due and owing at the time the Plan was submitted.

Under the Plan, the Debtor proposed to deposit the entire amount of the Class 2 claims into a Priority Tenant Deposit Account on the effective date or as soon thereafter as practicable. The Debtor would pay the entire amount of the deposit to each tenant, up to $900. Class 4 claims would be paid when they were due under state law. Plan at 15-16. Debtor contends the Court erred in finding that Class 2 and Class 4 were not impaired classes. He further argues that it is permissible to separately classify the tenant deposits and other unsecured claims.

Under Section 1124, a class is impaired under a plan unless the plan "leaves unaltered the legal, equitable, and contractual rights" of the holder of the claims. 11 U.S.C. § 1124(1). If the plan fully pays the class of creditors or owners in cash at the time the plan becomes effective, then the class is not impaired. 11 U.S.C. § 1124(3).[4] A

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[3] The 1994 amendments to the Bankruptcy Code increased the amount to $1,800. Said amendment is not applicable in this case because Debtor filed his petition prior to the date of the amendments.

[4] The 1994 amendments to the Code repealed Section 1124(3). The Section applies in this case.

class that is not impaired is "conclusively presumed to have accepted the plan." 11 U.S.C. § 1126(f).

The Bankruptcy Court found that Class 2 and Class 4 were not impaired under the Plan. The Court agrees. If Class 2 accepts the plan, the holders must be paid deferred cash payments of a value equal to the allowed amount of such claim. If the class does not accept the plan, the holders must be paid in full on the effective date. Section 1129(a)(9)(B). Thus, under Section 1124(1), Class 2 is not impaired.

The Plan proposed to pay the Class 4 security deposits to the tenants when they became due, i.e. when the tenants vacated the premises. The entire amount would be paid when a tenant vacated an undamaged apartment. The tenants' claims were also "unaltered" by the Plan and were not impaired under Section 1124(1). Since the tenant-deposit claims were not impaired, Class 2 and Class 4 could not accept the Plan for purposes of a cram down under Section 1129(a)(10). Thus, the Bankruptcy Court correctly found that it could not approve the Plan.

D. Trade Creditors' Claims

The Bankruptcy Court found that it was impermissible to separately classify the claims of trade creditors (Class 6) and general unsecured claims (Class 5). Memorandum Opinion at 18. Under the Plan, trade creditors were creditors who continued to do business with the Debtor after the Debtor filed for Chapter 11 protection. Since the Debtor's principle [sic] asset was an apartment building, trade creditors provided such services as trash

collection, pool maintenance, roof repair, etc. *Id.* Appellant argues separate classification is justified because trade creditors expect to earn profits from future dealings with the Debtor. They do not seek to recover only their pre-petition claims.

The Bankruptcy Court's finding was not clearly erroneous. There was no legitimate reason for segregating the trade creditors' claims. As the Bankruptcy Court noted, "literally thousands of companies are available to provide the [ ] services" of the trade creditors. *Id.* None of the trade creditors were essential to the Debtor's continued maintenance of the property. Where, as here, the Debtor's principle [sic] asset is an apartment building, there is no reason to separately classify the trade creditors' claims. *Boston Post Road,* 21 F.3d at 483. There is no legal distinction between the trade creditor claims and the general unsecured claims that would justify separate classification. *Tucson Self-Storage,* 166 B.R. at 898. Thus, separate classification was impermissible.

V. CONCLUSION

For the reasons stated, the Court finds that the Bankruptcy Court did not commit error. The Debtor did not submit a plan of reorganization that could be confirmed under the Bankruptcy Code. The Bankruptcy Court's orders granting LICV relief from the automatic stay and denying approval of the Second Amended Disclosure Statement are HEREBY AFFIRMED.

IT IS SO ORDERED.

Dated: Apr. 10, 1995

/s/ John G. Davies
JOHN G. DAVIES
United States
District Judge

ORIGINAL

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

IN RE: MOHAMMAD SAMIH BARAKAT, an individual, MOHAMMED S. BARAKAT, PLAINTIFF(S), v. Secured Creditor The Life Insurance Company of Virginia, DEFENDANT(S).	CASE NUMBER CV 94-6463 AWT BK# LA93-47514-GM ORDER RE TRANSFER PURSUANT TO GENERAL ORDER 224 (Related Case) (Filed Oct. 13, 1994)

CONSENT

I hereby consent to the transfer of the above-entitled case to my calendar pursuant to General Order 224.

Dated: Oct. 9, 1994 /s/ John G. Davies
JOHN G. DAVIES
United States District Judge

It appearing that the above-entitled case is properly transferable in accordance with the provisions of General Order 224,

IT IS HEREBY ORDERED that this case is transferred to the calendar of Judge JOHN G. DAVIES for all further proceedings.

Dated: Oct. 12, 1994 /s/ A. Wallace Tashima
A. WALLACE TASHIMA
United States District Judge

DECLINATION

I hereby decline to transfer the above-entitled case to/from my calendar for the reasons set forth:

_____

_____

_____

Dated: _____ /s/ _____
United States District Judge

Pursuant to the above transfer, any discovery matters that are or may be referred to a Magistrate Judge are hereby transferred from Magistrate Judge N/A to Magistrate Judge N/A REASON FOR TRANSFER AS INDICATED BY COUNSEL: Case CV94-6462 JGD and the present case –

[ ] A. appear to arise from the same or substantially identical transactions, happenings or events.

[ ] B. involve the same or substantially the same parties or property.

[ ] C. involve the same patent, trademark or copyright.

[ ] D. call for determination of the same or substantially identical questions of law.

[ ] E. likely for other reasons may entail unnecessary duplication of labor if heard by different judges.

NOTICE TO COUNSEL FROM CLERK:

On all documents subsequently filed in this case, please substitute the initials JGD after the case number in place of the initials of the prior judge, so that the case number will read CV 94-6463 JGD . This is very important because documents are routed to the assigned judges by means of these initials.

CV-34 (02/94) ORDER RE TRANSFER PURSUANT TO GENERAL ORDER 224 (Related Cases)

Attorney or Party Name,
Address and Telephone Number:

MARK T. YOUNG (Bar No. 89951) and
MARC A. LIEBERMAN (Bar No. 157318) of
MAYER, GLASSMAN & GAINES
11726 San Vicente Blvd., Suite 400
Los Angeles, California 90049-5006
(310) 207-0007

Attorney for Debtor/Debtor-in-Possession

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CALIFORNIA

In re: MOHAMMAD SAMIH BARAKAT,

Debtor.

CHAPTER 11
CASE NUMBER
LA 93-47514-GM

DATE: June 29, 1995
TIME: 10:00 a.m.
CTRM: 1568

ORDER ON APPLICATION FOR PAYMENT OF:
[X] INTERIM FEES AND/OR EXPENSES (11 USC § 331)
[ ] FINAL FEES AND/OR EXPENSES (11 USC § 330)

(Filed Jul. 14, 1995)

1. Name of Applicant (*specify*): MAYER, GLASSMAN & GAINES

2. This proceeding was heard at the date and place set forth above and was: [ ] Contested [X] Uncontested

3. Appearances were made as follows:

   a. [X] Applicant present in Court (Mark T. Young, partner of Mayer, Glassman & Gaines)

b. [ ] Attorney for Applicant present in Court (*Name*):

c. [ ] Attorney for U.S. Trustee present in Court

d. [ ] Other persons present as reflected in the court record

4. Applicant gave the required notice of the Application on (*specify date*): May 30, 1995

5. THE COURT ORDERS, GOOD CAUSE APPEARING:

a. [X] Application for Payment of Interim Fees is approved as follows:

(1) [X] Total amount allowed: $51,453.75

(2) [X] Amount/percentage authorized for payment at this time: 100%

b. [ ] Application for Payment of Final Fees is approved in the amount of: $

c. [X] Application for Reimbursement of [X] Interim [ ] Final Expenses is approved and authorized for payment:

(1) [X] Total amount allowed: $2,979.97

d. (1) [ ] Application Denied [ ] in Full [ ] in Part [ ] without Prejudice [ ] with Prejudice

(2) Grounds for Denial (*specify*):

e. [ ] The Court further orders (*specify*):

Dated: JUL 14 1995

/s/ GERALDINE MUND
JUDGE OF THE UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA
COUNTY OF LOS ANGELES

I am employed in the above County, State of California. I am over the age of 18 and not a party to the within action. My business address is as follows: 11726 San Vicente Blvd., Suite 400
Los Angeles,
California
90049-5006

On June 30, 1995, I served the foregoing document described as: ORDER ON APPLICATION FOR PAYMENT OF INTERIM OR FINAL FEES AND/OR EXPENSES on the interested parties at their last known address in this action by placing a true and correct copy thereof in a sealed envelope with postage thereon fully prepaid in the United States Mail at Los Angeles, California, addressed as follows:

U.S. TRUSTEE:
Office of the U.S. Trustee
221 N. Figueroa St., #800
Los Angeles, CA 90012

ATTORNEY FOR SECURED CREDITOR:
Jennifer Ann Golison, Esq.
Buchalter, Nemer, et al.
P.O. Box 7338
Newport Beach, CA 92658-7338

[ ] Addresses continued on next page

I declare under penalty of perjury the laws of the United States of America that the foregoing is true and correct.

Dated: June 30, 1995

JINX J. CLARK
Type Name

/s/ Jinx J. Clark
Signature

NOTE TO USERS OF THIS FORM:

Physically attach this form as the last page of the proposed Order or Judgment. Do not file this form as a separate document.

NOTICE OF ENTRY OF JUDGMENT OR ORDER AND CERTIFICATE OF MAILING

TO ALL PARTIES IN INTEREST ON THE ATTACHED SERVICE LIST:

1. You are hereby notified, pursuant to Local Bankruptcy Rule 116(1)(a)(iv), that a judgment or order entitled (*specify*): ORDER ON APPLICATION FOR PAYMENT OF INTERIM FEES AND/OR EXPENSES was entered on (*specify date*): JUL 20 1995

2. I hereby certify that I mailed a copy of this notice and a true copy of the order or judgment to the persons and entities on the attached service list on (*specify date*): JUL 20 1995

Dated: JUL 20 1995

JON D. CERETTO
Clerk of the Bankruptcy Court

By: /s/ Illegible
Deputy Clerk

June 1992 This form is optional. It has been approved for use by the United States Bankruptcy Court for the Central District of California.

In re Mohammed [sic] S. BARAKAT, Debtor and Debtor-in-Possession.

The LIFE INSURANCE COMPANY OF VIRGINIA, Movant,

v.

Mohammed [sic] S. BARAKAT, Respondent.

Bankruptcy No. LA 93-47514-GM.
Ref. No. LA 93-02964-GM.

United States Bankruptcy Court,
C.D. California.

Sept. 26, 1994.

Undersecured creditor, that had filed a prepetition complaint for judicial foreclosure of a building owned by the Chapter 11 debtor, filed motion for relief from automatic stay. The Bankruptcy Court, Geraldine Mund, J., held that: (1) separate classification of undersecured creditor's deficiency claim from unsecured claims was not justified; (2) the Bankruptcy Court was bound by decisions of bankruptcy appellate panel (BAP); (3) tenants of debtor were unimpaired for purposes of voting on reorganization plan; and (4) separate classification of trade creditors' claims lacked business justification.

Motion granted.

Jeffrey I. Golden and Jennifer Ann Golison, Buchalter, Nemer, Fields & Younger, Newport Beach, CA, for Life Ins. of Virginia.

Mark T. Young and Marc A. Lieberman, Mayer, Glassman & Gaines, Los Angeles, CA, for debtor Mohammed Samih Barakat.

MEMORANDUM OF OPINION ON MOTIONS FOR CONDITIONAL APPROVAL OF DISCLOSURE STATEMENT AND FOR RELIEF FROM THE AUTOMATIC STAY

GERALDINE MUND, Bankruptcy Judge.

Mohammed [sic] S. Barakat filed bankruptcy on October 22, 1993, principally to protect his apartment building from foreclosure by Life Insurance of Virginia ("LIV"), which is an undersecured creditor. The LIV note, made by the debtor and four relatives, was all due on September 1, 1989; however, it appears that it was extended from year to year. In June 1993, the remaining relatives conveyed title to this property to the debtor and his wife, and the debtor immediately defaulted on his payments to LIV. Settlement discussions took place between Barakat and LIV, but when no agreement was reached, LIV filed a complaint for judicial foreclosure and sought the appointment of a receiver. On the eve of the receivership hearing, the debtor filed this chapter 11 proceeding.

On November 17, 1993, LIV filed its motion for relief from the automatic stay. At the hearing, the Court granted adequate protection, allowing LIV to proceed with the non-judicial foreclosure action, but not to appoint a receiver. The motion for relief from stay was then continued to February 22, 1994, which was the date the Court had scheduled for a hearing to conditionally approve a disclosure statement. Thereafter, the LIV motion for relief from stay moved forward simultaneously with the hearing for conditional approval of the disclosure statement so that the Court could determine whether this property was necessary to an effective reorganization under 11 U.S.C. § 362(d)(2).

The proposed plan went through several revisions. At first, the process was delayed, because Barakat's original attorney lost his office in the Northridge earthquake. Later, however, Barakat obtained new counsel, who prepared an extensive and well thought out disclosure statement.

The plan creates seven classes, all of which are impaired: the secured claim of LIV in the amount of $3,970,000 and six unsecured classes. Two of the unsecured classes comprise the tenant security deposits for 51 tenants ($29,960 in priority claims of up to $900 per tenant and $3,805 in non-priority claims for 18 of those tenants). Thirteen trade creditors who will continue to do business with the debtor form a class in the total amount of $20,434. Insiders form another class in the amount of $29,516.31. Ten general unsecured creditors form a class in the amount of $21,616.22. And the LIV deficiency claim of $570,088.36 is separately classified.

There are only two non-exempt assets. One is the 83 unit apartment building valued at $3,970,000. The other is $95,360.72 which was accumulated during the pendency of the case, due to the fact that the debtor has collected rents but has not made any mortgage payments.

The Court reviewed the disclosure statement and noted certain major problems. The first issue was that there was no justification for separately classifying ongoing trade creditors from other general unsecured creditors in that this is an apartment building and not the type of business that must rely on its suppliers.

The Court then determined that the LIV deficiency claim must be part of the general unsecured class, and,

therefore, confirmation would require that the general unsecured creditors be crammed down under 11 U.S.C. § 1129(b), since LIV would dominate that class and would likely vote to reject. *See* § 1129(a)(8). The Court further found that security deposit creditors were artificially impaired. Since no impaired class (other than that of the insiders) existed except for the one dominated by LIV, there would be no consenting class without LIV's approval and the plan could not be confirmed under 11 U.S.C. § 1129(a)(10). The Court further found that even if the classification of LIV was proper, the debtor was only contributing "sweat equity" and, therefore, the plan would not meet the absolute priority rule. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988); *In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir.1993), *cert. granted*, ___ U.S. ___, 114 S.Ct. 681, 126 L.Ed.2d 648 (1994).

The matter was continued for the debtor to amend his proposed disclosure statement to deal with these problems. On August 9, 1994, the Court reviewed the new proposed disclosure statement and found that the only substantive change was that debtor's relatives would now be contributing $50,000 in cash as "new value." After oral argument, the Court made findings on the record and granted LIV relief from stay.

As the Court fully believes that this matter will and should be appealed, the Court delayed any foreclosure sale to allow the debtor to seek a stay pending appeal. That motion was granted on September 1, 1994, with the stay being conditioned on certain payments, management protection and other necessary actions by the debtor.

Although the Court made sufficient oral findings to meet the requirements of the Federal Rules of Bankruptcy, this memorandum reduces them to writing in order to focus the issues of the appeal.

SEPARATE CLASSIFICATION OF DEFICIENCY CLAIM

One of the recent "hot topics" in bankruptcy law is whether the deficiency claim of the undersecured creditor can (or must) be separately classified from all other unsecured creditors. This generally arises because the undersecured creditor has a deficiency claim which will overwhelm the unsecured creditor class and if the undersecured creditor is not separately classified, there will be no consenting class in compliance with 11 U.S.C. § 1129(a)(10).

The two leading theories that have come out of the circuit courts of appeals are *In the Matter of Woodbrook Assoc.*, 19 F.3d 312 (7th Cir.1994) and *In re Boston Post Road*, 21 F.3d 477 (2nd Cir.1994). These are diametrically opposed opinions. This Judge has struggled with the question and is most convinced by the Seventh Circuit theory that the existence of a right to elect under 11 U.S.C. § 1111(b) means that the undersecured real property creditor has different legal rights from other unsecured creditors and therefore separate classification is required. Very recently, however, in the case of *In re Tucson Self-Storage, Inc.*, 166 B.R. 892 (9th Cir. BAP 1994), the Ninth Circuit Bankruptcy Appellate Panel adopted the reasoning of the Second Circuit in *In re Boston Post Road*. The BAP held that separate classification of the

deficiency claim is inappropriate unless there is a business justification for it. No such business justification exists in this case.

If this BAP opinion did not exist, this Court would have followed the dictates of the Seventh Circuit and approved the separate classification of the LIV deficiency claim. However, this Court believes that it is bound by the decisions of the bankruptcy appellate panel under the rules of stare decisis.

STARE DECISIS EFFECT OF BAP RULINGS ON BANKRUPTCY COURTS

Another much debated issue is the effect of a BAP ruling on the bankruptcy court. No dispositive opinion has yet come down. This Court believes that it is bound by the decisions of the bankruptcy appellate panel. The theory behind this is set forth in the following paragraphs.

When Congress amended the Bankruptcy Code in 1984, it set up the initial appeal from bankruptcy court rulings on a dual track.[1] The appellant can choose to go either to the district court (in which the appeal would be heard by one district judge sitting in an appellate capacity) or to the bankruptcy appellate panel (in which the appeal would be heard by a group of three bankruptcy judges, none of whom came from the district in which the case arose). These two appellate entities sit at the same

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[1] Prior to that amendment, the Bankruptcy Act of 1978 included a third option of direct appeal to the circuit court of appeals, if the parties consented.

intermediate appellate level, as there is an appeal of right from either of them to the circuit court of appeals. This is a unique system and has raised many questions about the binding effect of decisions by the BAP and also the effect of decisions by the district court. This discussion is made even more complex, since bankruptcy judges are appointed under Article I of the Constitution, whereas district judges are appointed under Article III. Therefore, an additional issue is created as to whether the BAP decisions (given by a three-judge panel of Article I judges) have any stare decisis effect on an Article III district judge sitting as a bankruptcy judge under the withdrawal of reference procedures and, if so, whether they bind the district judge on non-core as well as in core proceedings.

Although the Article III/Article I debate is interesting and emotional, this Court feels that it is not the central issue. If there were no Article I/Article III dispute, the most logical approach to the dual track appellate process would be to view each appellate option as if it were the only vehicle for review and then to see the effect of the two tracks on each other. Further, it makes sense to first look at the application of each track to cases decided in the bankruptcy court. Therefore, we should ask, "what would be the effect of BAP decisions on bankruptcy judges, if that were the only method of initial appellate review from the bankruptcy court (i.e., if the district court route of appeal did not exist)?" To this Judge, the answer is clear: the BAP has all the qualifications of a stare decisis appellate review and this means

that its decisions are binding on any case which could be appealed to it.[2]

Stare decisis is a judge-created rule "to abide by, or adhere to, decided cases. [sic] Black's Law Dictionary 1406 (6th ed. 1990); *Taffi v. United States (In re Taffi)*, 144 B.R. 105 (Bankr.C.D.Cal.1992), *rev'd on other grounds, In re Taffi*, 1993 WL 558844 (C.D.Cal.1993). The doctrine stems from the common law maxim, "Stare decisis et non quieta movere," which is defined as "Let stand what is decided, and do not disturb what is settled." *Coyne v. Westinghouse Corp. (In re Globe Illumination)*, 149 B.R. 614, 617 (Bankr.C.D.Cal.1993), quoting 1B Jeremy C. Moore et al., *Moore's Federal Practice* ¶ 0.402[1] (2d ed. 1992). For years, well respected jurists, such as Justice Cardozo and the second Justice Harlan, believed in the importance of the policy of stare decisis. They recognized the need to have a starting point from which legal analysis could begin and a way to avoid the repeated litigation of identical issues in different cases. They further believed it was important for the law to provide stability and a clear guide for individual conduct, and for the judiciary to be one in which people could have faith. *In re Taffi*, 144 B.R. at 107-08; *see also* Black's Law Dictionary 1406 (6th Ed.1990).

Today, the judiciary continues to place heavy emphasis on those considerations. In *Payne v. Tennessee*, a criminal case pertaining to the admissibility of Victim Impact Statements in capital cases, the United States

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[2] Even though a party can opt out, this does not change the fact that the case *could* be appealed to the BAP.

Supreme Court overruled two of its previous decisions. Despite the fact that it did so, the court reaffirmed the importance of stare decisis and stated that stare decisis "promotes the evenhanded, predictable, and consistent development of legal principles; fosters reliance on judicial decisions; and contributes to the actual and perceived integrity of the judicial process." *Payne v. Tennessee*, 501 U.S. 808, 111 S.Ct. 2597, 115 L.Ed.2d 720 (1991), *reh'g denied*, 501 U.S. 1277, 112 S.Ct. 28, 115 L.Ed.2d 1110 (1991); *remanded sub nom., Owens v. State*, 1994 WL 112997 (Tenn.Crim.App. Mar. 25, 1994). In fact, one factor in the court's lengthy analysis was that the earlier cases, which had been decided by very narrow margins, had defied consistent application by lower courts. *Id.*

Stare decisis maintains a hierarchical dimension which is believed to be crucial to the efficient operation of the judicial system. No one contests that all inferior courts are bound by Supreme Court decisions. When no Supreme Court decision has been issued, the decisions of the court of appeals for a particular circuit are binding on all lower courts within that circuit. *Zuniga v. United Can Co.*, 812 F.2d 443 (9th Cir.1987); *In re Globe Illumination*, 149 B.R. at 617; *In re Taffi*, 144 B.R. at 108. Even if the circuits are split and the lower court disagrees with its own circuit, the lower court still must follow its court of appeals. *Id.*

Long ago, circuits and case loads were small enough so that a particular circuit could convene as a single court and decide all appeals. As caseloads and court sizes increased, however, the circuits established rotating panels made up of three judges from a circuit to do the job.

For a multi-panel system to work, it is necessary that all panels within a circuit be bound by the decisions of all other panels within the circuit. The doctrine of stare decisis, therefore, not only binds lower courts within a circuit to a court of appeals decision from that circuit, but also binds the court of appeals to its own rulings. 2A Fed.Proc.L.Ed. § 3:704 (1994). A decision of a panel on the court of appeals becomes the law of the circuit. One panel on a circuit cannot reverse the decision of another panel of the circuit, even if inclined to do so. *NLRB v. Datapoint Corp.*, 642 F.2d 123, 129 (5th Cir.1981); *Foss v. U.S.*, 865 F.2d 178, 180 (8th Cir.1989), *reh'g denied* (March 8, 1989). The only times that a panel is exempt from following the decision of another panel within the circuit are (1) if the Supreme Court, in the interim, rendered a contrary opinion which requires modification of an earlier circuit ruling, or (2) if the circuit, sitting en banc, issues a ruling which overrules the prior decision of a panel. *Datapoint*, 642 F.2d at 129.

An en banc review of a circuit decision is an opportunity to reconsider a panel's decision. *The Politics of En Banc Review*, 102 Harv.L.Rev. 864 (1989). The principal purpose of en banc review is to establish uniformity within the circuit among all the panels. *Id.* Such a review is an "extraordinary procedure intended to bring to the attention of the entire court an issue of exceptional public importance or a panel decision that allegedly conflicts with precedent of the Supreme Court or the circuit." 2A Fed.Proc.L.Ed. § 3:847. An en banc review will resolve an intra-circuit conflict between two panels. *Id.* This leads to certainty in the application of the law, which is the desired outcome of stare decisis.

Thus, if the initial appeal from the decision of a bankruptcy judge was only to the BAP, the rules of stare decisis would require that BAP decisions bind all bankruptcy courts in the circuit. *In re Proudfoot,* 144 B.R. 876 (9th Cir. BAP 1992); *In re Windmill Farms, Inc.,* 70 B.R. 618 (9th Cir. BAP 1987), *rev'd on other grounds,* 841 F.2d 1467 (9th Cir.1988). Then the sole question of the authority of the BAP would be whether it is binding on district judges who have withdrawn the reference of a bankruptcy case and are sitting as the trial judge/bankruptcy judge on the case. There would be no credible argument that bankruptcy judges throughout the circuit are not bound by the BAP's decisions.

EFFECT OF DISTRICT COURT APPELLATE RULINGS ON BANKRUPTCY JUDGES

However, an alternative appeal to the district court does exist. Therefore, the next question to be discussed is "What would be the effect of appellate decisions by district judges if there were no bankruptcy appellate panel?"[3]

When an appeal is taken to the district court[4], the judge who determines the appeal is not bound by the

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[3] Which is the situation in all circuits except the Ninth Circuit at this time.

[4] The discussion of the district court as an appellate authority only concerns core matters or other types of matters where no trial de novo is allowed. If the district is sitting in a matter in which there is a trial de novo, the district court is sitting as a trial court and not as an appellate court. The difference is that the appellate court is limited to review of the record below, whereas the trial court takes fresh evidence.

appellate decisions of his or her colleagues. An illustration of the nonexistence of any binding effect of a district judge's decision on other judges in the same district is the treatment in the Central District of California of the issue of whether a bankruptcy court may conduct a jury trial. The Ninth Circuit has never ruled on this issue. In *Gumport v. Growth Financial Corp. (In re Transcon Lines)*, 121 B.R. 837 (C.D.Cal.1990), Judge Tevrizian held that there was no authorization for the bankruptcy court to conduct jury trials. The following year, Judge Hupp, a colleague of Judge Tevrizian, came to a different conclusion. In *In re Great American Mfg. and Sales, Inc.*, 129 B.R. 633, 635 (C.D.Cal.1991), Judge Hupp specifically wrote:

> "No Ninth Circuit Court of Appeals decision has yet considered whether the bankruptcy court may conduct a jury trial in core matters. Judge Tevrizian of this court examined the issue in *Gumport v. Growth Financial Corp. (In re Transcon Lines)* 121 B.R. 837 (C.D.Cal.1990) and agreed with the reasoning of the Eighth and Tenth Circuits that there was no authority for the Bankruptcy Court to conduct jury trials. . . . This court reaches the opposite conclusion."

The fact that Judge Hupp was free to make a ruling which was inconsistent to that previously published by Judge Tevrizian clearly demonstrates that one judge of the district court is not bound by the prior decision of another.

Therefore in a district with more than one district judge, the appellate ruling by a district judge is only binding on the case in which it is made and not on the district as a whole unless the district judges themselves sit en banc and therefore bind themselves to the law

enunciated in that opinion.[5] In other words, unless the judges of the district court are willing to accept the concept that they are bound by prior decisions of their colleagues on issues before them, appellate holdings of the judges of the district court are not to be given stare decisis affect, for it is the willingness of the appellate court to create certainty in the law that requires trial courts in their "chain of command" to follow their authority.[6] Since most appellate decisions of the district court are not decisions of the district court en banc, but are decisions of a given district judge and are not binding on other district judges of that district, they should not be

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[5] Prior to 1991, bankruptcy judges assumed that they were bound by the appellate decisions of district judges. But since the holding in *In re Gaylor*, 123 B.R. 236 (Bankr.E.D.Mich.1991), there has been a general consensus that decisions of a district judge are not binding on the bankruptcy judges of that same district. For further discussion see Hon. Steven W. Rhodes, *Eight Statutory Causes of Delay and Expense in Chapter 11 Bankruptcy Cases*, 67 Am.Bankr.L.J. 287, 296-297. The Ninth Circuit Bankruptcy Appellate Panel had mentioned in *In re Windmill Farms*, 70 B.R. 618 (9th Cir. BAP 1987), *rev'd on other grounds*, 841 F.2d 1467 (9th Cir.1988), that the bankruptcy judges of a district are bound by the rulings of a district judge in that district. In the 1992 *Proudfoot* opinion, they reiterate that BAP decisions originating in any district of the circuit are binding precedent on all bankruptcy courts in the circuit in the absence of contrary authority from the district court of that district. There is no indication that the *Proudfoot* court revisited their prior ruling as to the authority of district court opinions.

[6] As noted above, just because a party can choose the BAP instead of the district court (or the district court instead of the BAP) does not remove the bankruptcy court from those courts who are subject to stare decisis decisions made by each of those appellate entities.

seen as binding on the bankruptcy judges of that district. *In re Gaylor,* 123 B.R. 236, 241-43 (Bkrtcy.E.D.Mich.1991).

This Court can find no authority for the proposition that district court appellate decisions are binding on anyone outside that district. The best analogy would be decisions by the various circuits. Those decisions are only binding on courts that are subject to appellate review by that circuit. Since bankruptcy decisions are subject to appellate review by the district court of that district, but not of any other district, they cannot be binding on bankruptcy courts from other districts.

Therefore, this Court believes that if there were no district court appellate review, the rulings of the bankruptcy appellate panel would be binding bankruptcy law on all bankruptcy judges within the circuit. If there were no bankruptcy appellate panel, this Court believes that an appellate decision of a district judge is only the law of the case unless the entire district court accepts the burden of stare decisis and binds itself to that decision.[7]

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[7] If the district court does an en banc opinion which conflicts with a BAP opinion, the bankruptcy judge is free to choose between them, just as if there were conflicting opinions of two panels of the circuit court in which the bankruptcy court sits. *In re Donaldson,* 156 B.R. 51, 54 (Bkrtcy.N.D.Cal.1993) *citing Auto Equity Sales, Inc. v. Superior Court,* 57 Cal.2d 450, 456, 20 Cal.Rptr. 321, 369 P.2d 937 (1962). *Auto Equity Sales* concisely summarizes the doctrine of stare decisis and notes that in conformance with the rules of stare decisis "where there is more than one appellate court decision, and such appellate decisions are in conflict . . . the court exercising inferior jurisdiction can and must make a choice between the conflicting decisions." *Auto Equity Sales,* 57 Cal.2d at 456, 20 Cal.Rptr. 321, 369 P.2d 937.

Although the above analysis is logical, the side-by-side system that exists is cumbersome and does not create the desired certainty of outcome. A trial judge in a bankruptcy case must follow the BAP rulings and yet, if the appeal is to the district court, the district judge could ignore that interpretation of the law in the same way that one circuit court of appeals "respectfully disagrees" with the decision by another circuit court of appeals.[8] So until the court of appeals in that circuit resolves the conflict, litigants never know what the binding interpretation of the law will be.

However, this uncertainty does not justify the added confusion caused by holding that no intermediate appellate authority is binding throughout the circuit. The fact that these two systems reside side-by-side does not change the stare decisis nature of BAP rulings. There is no reason that both the BAP and the district court appellate decisions must have identical affect, authority, or jurisdiction. This Judge believes that it would be improper to shrink the jurisdiction of the bankruptcy appellate panel solely because there is an alternative appellate process through the district court. It is equally incorrect to increase the affect of a district court appellate decision merely because the bankruptcy appellate panel

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[8] The current case is a fine example of this problem. If this appeal goes to the district court rather than to the BAP, the district judge can ignore *Tucson Self-Storage* and choose to follow the reasoning of *In the Matter of Woodbrook Assoc.* That then becomes the law of this case. Yet next time the same issue arises, I must rule under *Tucson Self Storage* and may be affirmed by a different district judge. Obviously this can lead to inconsistent application of the law.

exists. For that reason, this Court believes that it must follow the decision of *In re Tucson Self-Storage, Inc.*

EFFECT OF BAP RULINGS ON A DISTRICT JUDGE SITTING AS A TRIAL JUDGE ON A BANKRUPTCY CASE

For the appellate system to provide the desired certainty of outcome in bankruptcy cases, the initial appellate review should be able to establish circuit-wide law. Unfortunately the hybrid that exists does not meet that goal. Whereas one case can be decided by a bankruptcy judge and then requires an intermediate appeal to the BAP or the district court before it has an appeal of right to the circuit (28 U.S.C. § 158), another case involving the same issues of law can have the reference withdrawn, be decided by the district judge and then will be subject to immediate appeal to the circuit. *In re Manoa Finance Co.*, 781 F.2d 1370, 1372 (9th Cir.1986), *cert. denied* by *Yamamoto v. Klenske*, 479 U.S. 1064, 107 S.Ct. 948, 93 L.Ed.2d 997, *reh'g denied*, 480 U.S. 941, 107 S.Ct. 1594, 94 L.Ed.2d 783 (1987). This makes no logical sense and dramatically increases the costs and lengthens the time to final decision for the litigants whose case is decided by the bankruptcy judge. It also leads to more uncertainty since even BAP decisions are not binding on the district judge, since the BAP is not part of the district judge's appellate chain.[9]

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[9] To add even more confusion, there are now several reported cases where the district judge withdrew the reference of a bankruptcy case and then the parties consented to trial of an adversary proceeding before a magistrate judge. Appeal from this core matter determination by a non-Article III judge was directly to the court of appeals. *In re Acequia Inc.*, 34 F.3d 800 (9th

Therefore as the law now stands, a bankruptcy case being heard in the bankruptcy court should be decided by the bankruptcy judge in conformance with court of appeals rulings; but absent such decisions, it will be decided in accord with the BAP or the en banc decision of the district court for that district. On the other hand, if the reference is withdrawn, the district judge can ignore the BAP and will only be bound by the court of appeals. Since there are significantly fewer court of appeals bankruptcy decisions in the Ninth Circuit than BAP decisions, wide gaps exist in the areas of settled law.

This is an inefficient and ineffective situation. It is important that bankruptcy law be uniform throughout the country (as required by Article I § 8 of the Constitution), that final decisions be determined expeditiously, and that costs and delays be minimized. I suggest that Congress either create specialized panels of the court of appeals to assure expeditious operation in case processing and uniform laws of bankruptcy[10] or that the BAP be the only appeal of right from core matters (regardless of

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Cir.1994); *In the Matter of Toyota of Jefferson, Inc.*, 14 F.3d 1088 (5th Cir.1994). Further, under the theory enunciated in this opinion, the magistrate judge is not bound by any BAP or district court opinion.

[10] In the meantime, it would be wise if district judges would give deference to BAP decisions, whether they are sitting as trial judges or as appellate judges. As the BAP said in *In re Windmill Farms*, "We are not bound by the [district court appellate] decision in *In Matter of Escondido West Travelodge* [52 B.R. 376 (S.D.Cal.1985)] but pay great deference to decisions of the district court and as a matter of comity, we should follow such decisions when possible." *In re Windmill Farms*, 70 B.R. at 622.

whether they are heard by a bankruptcy judge or by a district judge).

The concept of stare decisis should not rest on whether the judges making the appellate determination have limited jurisdiction and limited judicial powers and whether that binds trial court judges of general jurisdiction and expanded judicial powers. Stare decisis came into the law to provide certainty in the application of law to a variety of cases. The work that the district judge does on a core matter in which the reference is withdrawn is work which is fully within the jurisdiction of an Article I bankruptcy judge and therefore it is irrelevant whether the person deciding the matter has Article III status or not. Thus a district judge who is handling core matters should be bound by stare decisis of the intermediate appellate process in the same way that a bankruptcy judge is bound; however, a district judge who is dealing with non-core matters would have these tangential bankruptcy issues decided as part of the non-bankruptcy appellate process from the district court directly to the court of appeals.

CLASSIFICATION OF TENANT DEPOSITS AND OF TRADE CREDITORS

The debtor has divided the tenants' pre-petition security deposits into two classes: Class 2, consisting of 51 individuals, for the priority claim portion of pre-petition deposits (up to $900 per individual) and Class 4, consisting of 18 claimants, for the non-priority portion of the pre-petition security deposits which are not presently due and owing. With respect to treatment of the claims,

Debtor states that the entire amount of the Allowed Class 2 Claims will be deposited into a segregated Priority Tenant Deposit Account on the effective date or as soon thereafter as practicable. As deposits are refundable, the entire amount of the required deposit payment, up to $900 each, will be paid from the account. For Class 4, no payments will be made until they are due under state law, at which time they will be paid from operating funds as an expense. In his disclosure statement, the debtor claims that these are impaired classes. The debtor cites *In re L & J Anaheim Associates,* 995 F.2d 940 (9th Cir.1993) for this proposition.

The Court does not agree with the debtor's position. The tenants have a right to recover their security deposits from the owner of the building at the time that they move out. This right is contingent and unliquidated until the tenant actually moves out and returns an undamaged unit to the owner. Because the plan proposes to pay the claimants in full at that time, the Court is of the opinion that the plan does not affect the rights of the tenants and the Court finds that they are unimpaired.[11] 11 U.S.C. § 1124(1).

In addition, even if Classes 2 and 4 were impaired, the Court does not find that these two classes have the kind of interest in the reorganization that Congress

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[11] In *L & J Anaheim,* 995 F.2d 940, the secured creditor was deprived of various contractual rights, including rights to foreclose under state law. These were not de minimis changes to the prepetition bargain of the parties. However the changes suggested by Barakat in his plan in the handling of the security deposits are mere form and not substance.

intended when it determined that at least one impaired class must vote for the plan.

There is little legislative history available on the purpose of § 1129(a)(10), but what little there is has been summarized in *In re Greystone III Joint Venture*, 102 B.R. 560 (Bkrtcy.W.D.Tex.1989). A few other cases discuss the matter and agree that the point of § 1129(a)(10) is to prevent the bankruptcy court from becoming a dumping ground for two party disputes. The cramdown provisions are not available to any person seeking to refinance his loan. "In short, there must be some one other than the debtor, other than the insiders, and other than the target of the cram down, who cares enough about the reorganization and whose rights must also be considered to invoke the equitable grounds that justify resort to cram down." *In re Anderson Oaks (Phase I) Limited Partnership*, 77 B.R. 108, 112-13 (Bankr.W.D.Tex.1987).

That impaired class must have a genuine interest in the reorganization. In *In re Franklin Mortgage & Investment Co., Inc.*, 143 B.R. 295 (Bkrtcy.D.Dist.Col.1992) the only unsecured creditor was an accounting firm owed $5000. The objecting secured creditor was owed $2,250,000. In deciding that the acceptance of the accountant was not sufficient to meet the requirements of § 1129(a)(10), the court stated, "[t]o allow the accounting firm's claim to serve that purpose would be a true case of the tail wagging the dog." *Id.* at 300 n. 1.

This Court believes that a tenant who has previously given a security deposit is not the kind of creditor who really has an interest in the debtor and in accepting the

reorganization proposal. Without a truly interested creditor accepting the plan, a Debtor should not be able to cramdown the principal creditor.

As to the trade creditors, this Court finds that there is no business justification for separate classification. Arguably a manufacturer or retailer might need to sweeten the pot for trade creditors in order to get future credit and inventory. But this is an apartment building and the trade creditors of this debtor are for such things as trash collection, pool service, roof repair, etc. In the greater Los Angeles area literally thousands of companies are available to provide these services. Further, the debtor has built up a war chest since he has not been making payments to LIV. If he truly felt that these trade creditors were crucial, there is no reason that he could not pay them in full on the effective date of the plan and then they would not be impaired. In *In re 266 Washington Associates,* 141 B.R. 275, 287 (Bkrtcy.E.D.N.Y.1992), the court found that the trade creditors (owed $26,800) were artificially impaired when the debtor had accumulated funds through not paying its mortgage and where the Debtor's partners would likely have access to funds to pay them in full at confirmation.

CRAMDOWN AND NEW VALUE EXCEPTION

At this point in time the Court has no need to determine whether the debtor could meet the requirements of § 1129(b) so as to cramdown LIV nor whether the $50,000 offer would meet the requirements of the new value exception under *Bonner Mall,* etc. First there has to be a consenting impaired class. As noted in *266 Washington*

Associates, "[s]ection 1129(a)(10) operates as a statutory gatekeeper barring access to cram down where there is absent even one impaired class accepting the plan." *Id.* Since there would be no consenting impaired class in this plan, the plan fails prior to having to look at the cram-down analysis.

GRANTING RELIEF FROM STAY

Because the debtor cannot propose a confirmable plan, the Court finds that the debtor has not met the requirements set forth in *United Sav. Assn. v. Timbers of Inwood Forest Associates, Ltd.,* 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988) that there be a probable reorganization within the foreseeable future. For that reason, the Court declines to conditionally approve[12] the disclosure statement and grants relief from the automatic stay so that LIV can proceed with its foreclosure sale.

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[12] Shortly after filing, the debtor was ordered to submit a disclosure statement by a date certain so that it could be reviewed by the Court and Office of the United States Trustee. If it were conditionally approved, it would be disseminated to all parties in interest for a combined disclosure statement/confirmation hearing.

MARK T. YOUNG (Bar No. 89951) and
MARC A. LIEBERMAN (Bar No. 157318) of
MAYER, GLASSMAN & GAINS
11726 San Vicente Boulevard, Suite 400
Los Angeles, California 90049-5006
(310) 207-0007

Attorneys for Debtor,
MOHAMMAD SAMIH BARAKAT

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In re:	) Case No. LA 93-47514-GM
MOHAMMAD SAMIH BARAKAT, an individual,	) [Chapter 11]
Debtor.	) Ref. No. MO 93-02964-GM
	) ORDER GRANTING STAY
THE LIFE INSURANCE COMPANY OF VIRGINIA,	) PENDING APPEAL
Movant,	) (Filed Sep. 8, 1994)
vs.	) Date: September 1, 1994
MOHAMMAD SAMIH BARAKAT,	) Time: 10:00 a.m.) Ctrm: 1568
Respondent.	

The "Motion for Stay Pending Appeal of 'Order Granting Motion for Relief from the Automatic Stay Pursuant to 11 U.S.C. §362' " ("the Motion") filed herein by Debtor/Debtor-in-Possession MOHAMMAD SAMIH BARAKAT ("Debtor") came on for hearing on September 1, 1994 on the 10:00 a.m. calendar, pursuant to an Order

Shortening Time. Debtor was represented by his attorney, Marc A. Lieberman of Mayer, Glassman & Gaines. Respondent (on this Motion)/Movant (on the underlying motion for relief from automatic stay) THE LIFE INSURANCE COMPANY OF VIRGINIA ("LICV") was represented by its attorneys, Jeffrey I. Golden and Jennifer Ann Golison of Buchalter, Nemer, Fields & Younger. No other appearances were made.

The Court having reviewed the pleadings on file herein and having heard argument of counsel, IT IS HEREBY ORDERED that the Motion is GRANTED on the conditions stated in this Order. Specifically, the "Order Granting Motion for Relief from the Automatic Stay Pursuant to 11 U.S.C. §362" entered herein on August 15, 1984 [sic] ("the Relief Order") is hereby STAYED pending the appeal of the Relief Order to United States District Court for the Central District of California, subject to the following terms and conditions:

1. Debtor shall bring and remain current on all property taxes due on the subject real property (14420 Kittridge Street, Van Nuys, California 91405) ("the Property").

2. Debtor shall maintain insurance on the Property as such insurance is maintained as of September 1, 1994, and will add LICV as a loss payee to any additional or renewed insurance on the Property.

3. Debtor shall maintain the condition of the Property as it existed as of September 1, 1994. Debtor shall not defer expenses which are required to maintain the condition of the Property.

4. Debtor shall make monthly payments to LICV in the sum of $27,500. Such payments represent interest payments at 11% per annum on the secured portion of the debt to LICV, based on an estimated value of the Property of $3,000,000. Such monthly payments are due by the tenth (10th) day of each month, commencing on September 10, 1994. Such payments may be made from the rents, issues, and profits generated by the Property ("the Rents").

5. Debtor is authorized to pay from the Rents the Budgeted Expenses enumerated in the prior Stipulation re Cash Collateral with LICV. Debtor is not required to seek LICV's approval to pay any such Budgeted Expenses.

6. Debtor is authorized to pay from the Rents usual and customary monthly management fees for management of the Property, subject to the right of LICV to object to payment of such fees.

7. Debtor shall not pay from the Rents any expense other than payments to LICV (as described in Paragraph 4 hereinabove), the Budgeted Expenses (as described in Paragraph 5 hereinabove), and management fees (as described in Paragraph 6 hereinabove), without the prior written approval of LICV, or an order of this Court.

8. In the event that Debtor does not have enough funds to pay the required monthly payment to LICV and the Budgeted Expenses, Debtor must make up the deficit from non-estate sources in order to pay such amounts as they become due.

9. In the event that Debtor has excess funds after payment to LICV, payment of the Budgeted Expenses, and payment of management fees, all such funds shall be deposited into Debtor's debtor-in-possession account.

10. In the event of a default under any of the terms of this Order, LICV may provide written notice of the default to Debtor and his counsel via facsimile. If the default is not cured or if Debtor has not obtained an Order from the Bankruptcy Court regarding the non-existence of the asserted default within ten (10) days after the Order is received by facsimile, LICV will be entitled to conduct a foreclosure sale of the Property.

Dated: SEP 8 1994

GERALDINE MUND
GERALDINE MUND, Judge
United States Bankruptcy Court

APPROVED AS TO FORM AND CONTENT:

BUCHALTER, NEMER, FIELDS & YOUNGER,
A Professional Corporation

By: /s/ Jennifer Ann Golison
JENNIFER ANN GOLISON,
Attorneys for THE LIFE INSURANCE
COMPANY OF VIRGINIA

NOTE TO USERS OF THIS FORM:

Physically attach this form as the last page of the proposed Order of Judgment.
Do not file this form as a separate document.

In re (SHORT TITLE)
MOHAMMAD SAMIH BARAKAT, an individual,

Debtor.

CHAPTER 11
CASE NUMBER:

LA 93-47514-GM

NOTICE OF ENTRY OF JUDGMENT OR ORDER AND CERTIFICATE OF MAILING

TO ALL PARTIES IN INTEREST ON THE ATTACHED SERVICE LIST:

1. You are hereby notified, pursuant to Local Bankruptcy Rule 116(1)(a)(iv), that a judgment or order entitled (*specify*):

   ORDER GRANTING STAY PENDING APPEAL

   was entered on (*specify date*): SEP 8 1994

2. I hereby certify that I mailed a copy of this notice and a true copy of the order or judgment to the persons and entities on the attached service list on (*specify date*):

   SEP 8 1994

Dated: SEP 8 1994

JON D. CERETTO
Clerk of the Bankruptcy Court

By: /s/ Illegible
Deputy Clerk

MARK T. YOUNG (Bar No. 89951) and
MARC A. LIEBERMAN (Bar No. 157318) of
MAYER, GLASSMAN & GAINES
11726 San Vicente Boulevard, Suite 400
Los Angeles, California 90049-5006
(310) 207-0007

Attorneys for Debtor/Debtor-In-Possession,
MOHAMMED [sic] S. BARAKAT

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

In re:	Case No. LA 93-47514-GM [Chapter 11]
MOHAMMED [sic] S. BARAKAT,	ORDER APPROVING APPLICATION BY DEBTOR-IN-POSSESSION TO EMPLOY SUBSTITUTE GENERAL BANKRUPTCY COUNSEL NUNC PRO TUNC TO APRIL 14, 1994 (MAYER, GLASSMAN & GAINES)
Debtor/Debtor-in-Possession.	(Filed Aug 31, 1994)
	Date: August 11, 1994 Time: 10:00 a.m. Ctrm: 1568

At the place and time above-stated, there came on for hearing on regular notice the "Application by Debtor-in-Possession to Employ Substitute General Bankruptcy Court Nunc Pro Tunc to April 14, 1994" (the "Application"). Marc A. Lieberman appeared on behalf of

Mohammed [sic] S. Barakat, Debtor and Debtor-in-Possession ("Debtor"). There were no other appearances. Having considered the Application and declarations and exhibits filed in support thereof, and finding that notice was proper, the Court hereby approves the employment of Mayer, Glassman & Gaines nunc pro tunc to April 14, 1994 as substitute general counsel to Debtor.

Date: Aug. 31, 1994

/s/ **GERALDINE MUND**
UNITED STATES
BANKRUPTCY JUDGE

NOTE TO USERS OF THIS FORM:

Physically attach this form as the last page of the proposed Order or Judgment.
Do not file this form as a separate document.

In re (SHORT TITLE) CHAPTER 11 CASE NUMBER:
MOHAMMED [sic] S. BARAKAT,
Debtor
LA 93-47514-GM

NOTICE OF ENTRY OF JUDGMENT OR ORDER AND CERTIFICATE OF MAILING

TO ALL PARTIES IN INTEREST ON THE ATTACHED SERVICE LIST:

1. You are hereby notified, pursuant to Local Bankruptcy Rule 116(1)(a)(iv), that a judgment or order entitled (*specify*):

   ORDER APPROVING APPLICATION BY DEBTOR-IN-POSSESSION TO EMPLOY SUBSTITUTE GENERAL BANKRUPTCY COUNSEL NUNC PRO TUNC

TO APRIL 14, 1994 (MAYER, GLASSMAN & GAINES)

was entered on (*specify date*): Sep. 6, 1994

2. I hereby certify that I mailed a copy of this notice and a true copy of the order or judgment to the persons and entities on the attached service list on (*specify date*): Sep. 6, 1994

Dated: Sep. 6, 1994

JOHN D. CERETTO
Clerk of the
Bankruptcy Court

By: /s/ A.H.
Deputy Clerk

BUCHALTER, NEMER, FIELDS & YOUNGER
A Professional Corporation
JEFFREY I. GOLDEN #133040
JENNIFER ANN GOLISON #145285
660 Newport Center Drive, Suite 1400
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Attorneys for Secured Creditor
The Life Insurance Company of Virginia

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In re	Case No. LA 93-47514 GM
MOHAMMED [sic] S. BARAKAT,	Chapter 11
	ORDER DENYING APPROVAL OF DEBTOR'S SECOND AMENDED DISCLOSURE STATEMENT
Debtor and Debtor-in-Possession.	**(Filed Aug. 11, 1994)** **Date: August 9, 1994** **Time: 9:00 a.m.** **Ctrm: LA-1568**

On August 9, 1994 the Court held the hearing on the approval of the Second Amended Disclosure Statement of Mohammed [sic] S. Barakat ("Debtor"). Mark T. Young of Mayer, Glassman & Gaines appeared on behalf of the Debtor. Jeffrey I. Golden and Jennifer Ann Golison of Buchalter, Nemer, Fields & Younger appeared on behalf of creditor The Life Insurance Company of Virginia.

Based upon the original Motion, the supplemental pleadings, and oral argument at the hearing, the Court made oral findings of fact and conclusions of law on the record pursuant to FRBP 7052.

IT IS SO ORDERED that the Court denies approval of the Debtor's Second Amended Disclosure Statement.

DATED:
AUG 11 1994

GERALDINE MUND
THE HONORABLE GERALDINE MUND UNITED STATES BANKRUPTCY JUDGE

APPROVED AS TO FORM AND CONTENT:

DATED:
August 9, 1994

MAYER, GLASSMAN & GAINES

/s/ Mark T. Young
MARK T. YOUNG,
Attorneys for the Debtor

DATED:
August 9, 1994

BUCHALTER, NEMER, FIELDS & YOUNGER,
A Professional Corporation

/s/ Jennifer Ann Golison
JENNIFER ANN GOLISON,
Attorneys for The Life Insurance Company of Virginia

NOTE TO USERS OF THIS FORM:

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In re (SHORT TITLE)

MOHAMMED [sic] S. BARAKAT Debtor.

CHAPTER 11 CASE NUMBER:

LA 93-47514 GM

NOTICE OF ENTRY OF JUDGMENT OR ORDER AND CERTIFICATE OF MAILING

TO ALL PARTIES IN INTEREST ON THE ATTACHED SERVICE LIST:

1. You are hereby notified, pursuant to Local Bankruptcy Rule 116(1)(a)(iv), that a judgment or order entitled (*specify*): Order Denying Approval of Debtor's Second Amended Disclosure Statement

was entered on (*specify date*): AUG 16 1994

2. I hereby certify that I mailed a copy of this notice and a true copy of the order or judgment to the persons and entities on the attached service list on (*specify date*): AUG 16 1994

Dated: AUG 16 1994

Jon D. Ceretto
Clerk of the Bankruptcy Court

By: /s/ AH
Deputy Clerk

BUCHALTER, NEMER, FIELDS & YOUNGER
A Professional Corporation
JEFFREY I. GOLDEN #133040
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Attorneys for Secured Creditor
The Life Insurance Company of Virginia

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

In re MOHAMMED [sic] S. BARAKAT, Debtor and Debtor-in-Possession.	Case No. LA 93-47514 GM Chapter 11 Ref No. MO 93-02964 GM
THE LIFE INSURANCE COMPANY OF VIRGINIA, Movant, vs. MOHAMMED [sic] S. BARAKAT, Respondent.	**ORDER GRANTING MOTION FOR RELIEF FROM THE AUTOMATIC STAY PURSUANT TO 11 U.S.C. § 362** **(Filed Aug. 9, 1994)** **Date: August 9, 1994** **Time: 9:00 a.m.** **Ctrm: LA-1568**

On August 9, 1994 the Court held the final hearing on the motion for relief from the automatic stay pursuant to 11 U.S.C. §362 ("Motion") brought by The Life Insurance Company of Virginia ("LICV") against Mohammed [sic] S. Barakat ("Debtor"). Mark T. Young of Mayer, Glassman & Gaines appeared on behalf of the Debtor. Jeffrey I. Golden and Jennifer Ann Golison of Buchalter, Nemer, Fields & Younger appeared on behalf of the movant LICV. Based upon the original Motion, the supplemental pleadings, and oral argument at the hearing, the Court made oral findings of fact and conclusions of law on the record pursuant to FRBP 7052.

IT IS SO ORDERED that LICV's Motion for an Order for Relief from the Automatic Stay is granted. LICV has all rights it may have against the Debtor to proceed against the Property described in the Motion and which is subject of LICV's security interest, including, but not limited to, conducting a foreclosure sale, subject to the limitations in this Order.

IT IS FURTHER ORDERED that LICV cannot conduct a foreclosure sale before September 9, 1994.

IT IS FURTHER ORDERED that LICV does not have relief from stay to seek appointment of a receiver absent further order of this Court.

DATED:
AUG 9 1994

GERALDINE MUND
THE HONORABLE GERALDINE MUND UNITED STATES BANKRUPTCY JUDGE

APPROVED AS TO FORM AND CONTENT:

DATED:
August 9, 1994

MAYER, GLASSMAN & GAINES

/s/ Mark T. Young
MARK T. YOUNG,
Attorneys for the Debtor

DATED:
August 9, 1994

BUCHALTER, NEMER, FIELDS & YOUNGER,
A Professional Corporation

/s/ Jennifer Ann Golison
JENNIFER ANN GOLISON,
Attorneys for The Life Insurance Company of Virginia

NOTE TO USERS OF THIS FORM:

Physically attach this form as the last page of the proposed Order or Judgment. Do not file this form as a separate document.

In re (SHORT TITLE)

MOHAMMED [sic] S. BARAKAT Debtor.

CHAPTER 11 CASE NUMBER:

LA 93-47514 GM

NOTICE OF ENTRY OF JUDGMENT OR ORDER AND CERTIFICATE OF MAILING

TO ALL PARTIES IN INTEREST ON THE ATTACHED SERVICE LIST:

1. You are hereby notified, pursuant to Local Bankruptcy Rule 116(1)(a)(iv), that a judgment or order

entitled (*specify*): Order Granting Motion for Relief From the Automatic Stay Pursuant to 11 U.S.C. Section 362

was entered on (*specify date*): 8/15/94

2. I hereby certify that I mailed a copy of this notice and a true copy of the order or judgment to the persons and entities on the attached service list on (*specify date*): 8/15/94

Dated: 8/15/94

Jon D. Ceretto
Clerk of the Bankruptcy Court

By: /s/ AH
Deputy Clerk

BUCHALTER, NEMER, FIELDS & YOUNGER
A Professional Corporation
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Attorneys for Secured Creditor
The Life Insurance Company of Virginia

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

In re MOHAMMED [sic] S. BARAKAT, Debtor and Debtor-in-Possession.	Case No. LA 93-47514 GM Chapter 11 Ref No. MO 93-02964
THE LIFE INSURANCE COMPANY OF VIRGINIA, Movant, vs. MOHAMMED [sic] S. BARAKAT, Respondent.	**ORDER GRANTING MOTION FOR RELIEF FROM THE AUTOMATIC STAY PURSUANT TO 11 U.S.C. § 362** (Filed Jan. 11, 1994) **Date: December 23, 1993** **Time: 10:00 a.m.** **Ctrm: LA 1568**

The Motion of The Life Insurance Company of Virginia ("LICV") for Relief from the Automatic Stay pursuant to 11 U.S.C. § 362 ("Motion") was heard on December 23, 1993 at 10:00 a.m. in Courtroom 1568, the Honorable Geraldine Mund presiding. Jennifer Ann Golison, Esq. and Jeffrey I. Golden, Esq. of Buchalter, Nemer, Fields & Younger, a Professional Corporation, appeared on behalf of LICV. Gary Kleinman, Esq. appeared on behalf of the Debtor.

IT IS SO ORDERED that LICV is granted immediate relief from the automatic stay pursuant to 11 U.S.C. § 362 to:

(1) pursue its judicial foreclosure, through sale, against the Property described below; and

(2) pursue its nonjudicial foreclosure against the Property described below, except that LICV cannot proceed with the foreclosure sale without further order of the Court.

The subject real property is located at 14420 Kittridge Street, Van Nuys, California, and legally described as follows:

> Lots 7, 8, 9, 10, 11, 12 and 13 in Block 24 of Tract No. 1200, in the City of Los Angeles, County of Los Angeles, State of California, as per map recorded om [sic] Book 19, Page 35 of Maps in the office of the County Recorded [sic] of said County.

IT IS FURTHER ORDERED that LICV does not have relief from the automatic stay for the purpose of appointing a receiver.

DATED: JAN 11 1994

GERALDINE MUND
THE HONORABLE GERALDINE MUND
UNITED STATES BANKRUPTCY JUDGE

Attorney or Party Name, Address and Telephone Number

BUCHALTER, NEMER, FIELDS & YOUNGER
JENNIFER ANN GOLISON #145285
P.O. Box 7338
Newport Beach, California 92658-7338
(714) 760-1121

Attorney for Secured Creditor

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In re: MOHAMMED [sic] S. BARAKAT

Debtor.

THE LIFE INSURANCE COMPANY OF VIRGINIA	)	CHAPTER 11
	)	CASE NUMBER
Movant(s)/Plaintiff(s),	)	LA 93-47514 GM
	)	
vs.	)	X REFERENCE
	)	NUMBER
MOHAMMED [sic] S. BARAKAT	)	MO 93-02964
	)	ADVERSARY
Respondent(s)/Defendant(s).	)	NUMBER

NOTICE OF ENTRY OF JUDGMENT OR ORDER AND CERTIFICATE OF MAILING

TO ALL PARTIES IN INTEREST ON THE ATTACHED SERVICE LIST:

1. You are hereby notified, pursuant to Local Bankruptcy Rule 116(1)(a)(iv), that a judgment* or order entitled (*specify*):

   Order Granting Motion for Relief from the Automatic Stay Pursuant to 11 U.S.C. Section 362

   was entered on (*specify date*): JAN 13 1994

2. I hereby certify that I mailed a copy of this notice and a true copy of the order or judgment to the persons and entities on the attached service list on (*specify date*):

   JAN 13 1994

Dated: JAN 13 1994

Clerk of the Bankruptcy Court

By: /s/ AH
Deputy Clerk

---

* *If a judgment is by default, a copy of the judgment must be attached to this notice.*

LAW OFFICES OF GARY KLEINMAN
5400 VAN NUYS BLVD. #504
SHERMAN OAKS, CA 91401
818-990-7800
STATE BAR #85232

Attorney for Debtors,
MOHAMMAD SAMIH BARAKAT,

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

In Re:	CASE # LA-93-47514 GM CHAPTER 11
MOHAMMAD SAMIH BARAKAT, Debtors,	PROPOSED ORDER APPROVING APPLICATION TO EMPLOY GARY KLEINMAN AS COUNSEL FOR DEBTOR:
	(Filed Nov. 18, 1993)

The Application of Debtor to Employ, GARY KLEINMAN, as Counsel for Debtor-In-Possession has been reviewed, and after such consideration, does hereby approve said employment upon the terms and conditions as set forth in the Application.

11/18/93 /s/ Lisa H. Fenning
HONORABLE LISA H. FENNING
U.S. BANKRUPTCY JUDGE

Supreme Court, U.S.
FILED
FEB 24 1997
CLERK

No. 96-1161

In The

Supreme Court of the United States

October Term, 1996

MOHAMMED SAMIH BARAKAT, an individual,

Petitioner,

v.

THE LIFE INSURANCE COMPANY OF VIRGINIA,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether this Court should grant certiorari to determine if the debtor demonstrated a separate business or economic justification for separately classifying the mortgage deficiency claim of The Life Insurance Company of Virginia?

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

The Life Insurance Company of Virginia ("LICV") hereby opposes the Petition for Writ of Certiorari ("Petition") filed by Mohammed S. Barakat ("Barakat"), the debtor in the underlying chapter 11 bankruptcy case, and respectfully represents as follows:

I. STATEMENT OF THE CASE

Barakat's statement of the case is mostly accurate, with one key omission. Barakat fails to include in the Petition that the bankruptcy court found that he failed to demonstrate any reason for separately classifying LICV's mortgage deficiency claim as required by the binding decision of *In re Tucson Self-Storage, Inc.*, 166 B.R. 892 (Bankr. 9th Cir. 1994). The Debtor never offered any evidence of, and the bankruptcy court found that "[n]o such business justification exists in this case." [*See* Appendix attached to Barakat's Petition ("Appendix"), page A-66.]

II. THE DENIAL OF THE WRIT IS MANDATED

A. Introduction

Five circuit courts have held that a debtor must have a separate economic or business justification to separately classify a mortgage deficiency claim of a secured creditor in a plan of reorganization. These decisions are supported by sound policy, legislative intent, and the express language of the Bankruptcy Code. One circuit court has held otherwise. The anomalous decision of one circuit court

does not create a conflict between the circuits. The decision herein does not significantly affect chapter 11 bankruptcy cases. Additionally, recent amendments to the Bankruptcy Code resolve the issue and thus mandate denial of Barakat's Petition.

B. Summary of Argument

Barakat's Petition should be denied for several compelling reasons. First, the Petition does not present a significant issue of federal law, but rather only Barakat's failure to meet the factual requirements of the applicable standard of law. The Ninth Circuit's decision herein is plainly limited to the facts this case.

Second, the decision of the Seventh Circuit misinterprets both Sections 1122 and 1129 of the Bankruptcy Code[1] and thus there is no conflict between the circuit courts. Barakat incorrectly asserts that thousands of chapter 11 cases will be affected by the Ninth Circuit's decision. The issue decided in this case has limited application and thus does not present a significant federal question of law.

In addition to the Ninth Circuit's decision herein, the Second, Third, Fifth, and Eighth Circuits have uniformly held that it is impermissible to separately classify a Section 1111(b) deficiency claim of an undersecured creditor without an independent justification. *In re Boston Post Road Ltd. Partnership*, 21 F.3d 477 (2d Cir. 1994); *In re Greystone III Joint Venture*, 995 F.2d 1274 (5th Cir. 1991)

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[1] Title 11 of the United States Code. All references to sections are to the Bankruptcy Code unless otherwise stated.

(thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan); *In re Bryson Properties, XVIII*, 961 F.2d 496 (4th Cir. 1992); *In re Lumber Exchange Building Ltd. Partnership*, 968 F.2d 647 (8th Cir. 1992); *John Hancock Mut. Life Ins. Co. v. Route 37 Business Park Assocs.*, 987 F.2d 154 (3rd Cir. 1993).

Barakat contends that separate classification of a deficiency claim is mandatory pursuant to the Seventh Circuit's decision in *Matter of Woodbrook Associates*, 19 F.3d 312 (7th Cir. 1994). Barakat asserts and the Seventh Circuit holds the minority position which is not substantiated by the plain meaning of the applicable statutes, their legislative history, or policy considerations.

Finally, recent amendments to Section 1124 of the Bankruptcy Code have modified the definition of "impairment." As a result, debtors may now more easily create an "impaired consenting class" of administrative convenience claims to meet the requirements of Section 1129(a)(10), thus alleviating the need to separately classify mortgage deficiency claims. Accordingly, Barakat's Petition should be denied.

C. Barakat Failed to Offer Any Justification for Separately Classifying LICV's Deficiency Claim

Barakat failed to offer any evidence or justification for separately classifying LICV's deficiency claim and thus failed to meet the applicable standard of law. The bankruptcy court specifically found that "no such justification exists in this case." [Appendix, page 66.] Thus, the Ninth Circuit's decision is limited to the particular

facts of this case and does not present a question of federal law.

D. Barakat and the Seventh Circuit Misinterpret the Bankruptcy Code

Barakat improperly classified LICV's unsecured claim in contravention of Sections 1122 and 1129 of the Bankruptcy Code to gerrymander its general unsecured creditor class, without any evidence or offer of proof of an independent business or economic justification. Such gerrymandering is impermissible and in violation of Sections 1129(a) and 1129(b) because Barakat failed to offer or prove any separate business or economic justification for separate classification.

1. The Plain Meaning of Section 1122 Does Not Authorize the Unfettered Separate Classification of Deficiency Claims

Barakat follows the decision of the Seventh Circuit and argues that the plain meaning of Section 1122(a) allows debtors the unfettered right to separately classify similar claims. The Seventh Circuit and Barakat incorrectly interpret subsection (a) in a vacuum, ignoring other sections of the Bankruptcy Code. One must analyze the Bankruptcy Code as a whole, in order to properly understand particular sections.

> "Statutory construction, however, is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme – because the

> same terminology is used elsewhere in a context that makes its meaning clear."

United Savings Association v. Timbers of Inwood Forest, 484 U.S. 365, 371, 108 S.Ct. 626, 630, 98 L.Ed.2d 740 (1988).

Section 1122 provides the general guidelines for the classification of claims as follows:

> "(a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.
>
> (b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience."

Barakat's interpretation ignores subsection (b) of Section 1122, as well as other sections of the Bankruptcy Code such as Section 1111(b). Section 1122(b) provides authority for the separate classification of claims for the sake of administrative convenience, i.e., claims of small amounts. If subsection (a) allows a debtor to separately classify similar claims, then subsection (b) would be unnecessary altogether.

> "A fair reading of both subsections suggests that ordinarily 'substantially similar claims,' those which share common priority and rights against the debtor's estate, should be placed in the same class."

Greystone III, 948 F.2d at 139. The Fifth Circuit in *Greystone III* concluded that:

> "if § 1122(a) permits classification of 'substantially similar' claims in different classes, such classification may only be undertaken for reasons independent of the debtor's motivation to secure the vote of an impaired, assenting class of claims."

Id. at 139.

Additionally, one cannot analyze Section 1122(a) without acknowledging Section 1111, which provides in relevant part that:

> "(b)(1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claims had recourse against the debtor on account of such claim, whether or not such holder has such recourse unless –
>
> (i) the class of which such claims is a part elects, by at least two-thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection; . . .
>
> (2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed."

Section 1111(b)(2) would be meaningless if Section 1122(a) is interpreted to allow for the separate classification of a secured creditor's deficiency claim. *Greystone III*, 948 F.2d at 140. Section 1111(b)(2) allows an undersecured secured creditor to choose the treatment of its claim. The creditor may choose not to make the election, thus bifurcating the creditor's claim into a secured claim in the amount of the value of the collateral, and an unsecured

claim for the deficiency. This provides the creditor with a lower secured claim, thus lower payments on the secured claim over the life of the plan, while allowing the secured creditor to vote as a general unsecured creditor in the amount of its deficiency claim.

The secured creditor may elect treatment under Section 1111(b)(2), thus requiring that the entire claim be treated as secured in the plan of reorganization even though the value of the collateral is less than the claim amount. This would provide the secured creditor with a higher secured claim under the plan of reorganization, thus higher payments on this claim over the life of the plan, but the creditor would not be able to vote along with the general unsecured creditors. The election under Section 1111(b)(2) to bifurcate would have no meaning or purpose since separate classification of the deficiency claim would effectively disenfranchise the creditor's unsecured claim and prevent that unsecured claim from having any voice with other unsecured creditors.

2. Other Bankruptcy Code Sections Do Not Permit Unfettered Classification

Barakat's reading of Section 1122 also violates Section 1129(a), the section governing the elements which must be shown for confirmation and Section 1129(b), the section governing "cramdown" over a non-consenting class. By allowing separate classification of unsecured claims without any justification, a debtor could literally separately classify every single creditor, until at least one vote is found in favor of the plan, and thus obtaining the "accepting class" required by Section 1129(a)(10). Such a

modest threshold would make a mockery of the (b)(1) cramdown requirement which, among other things, requires that the plan "not discriminate unfairly." The "balance of power" between the plan proponent, usually the debtor, and the estate's creditors would be tilted out of balance and the vote of any non-consenting class or classes, irrespective of number or size, is held hostage to the plan proponent's cramdown effort. Any notion of democracy or majority rule which underlies the reorganization process is severely compromised.

Barakat's interpretation of Section 1122 also mocks Section 1126(c) which defines an accepting class as one in which at least two-thirds in amount and more than half in number have accepted. There would be no need for the percentages of Section 1126(c) if the plan proponent could simply separately classify every creditor, ensuring a 100% vote in each class. Such a twisted interpretation has been rightly rejected by the majority of other circuits, as discussed below.

E. The Majority Rule of the Circuit Courts

The Second, Third, Fifth, Eighth, and now Ninth Circuits have held that it is impermissible to separately classify a Section 1111(b) deficiency claim of an undersecured creditor without an independent justification. *Boston Post Road*, 21 F.3d 477; *Greystone III*, 995 F.2d 1274; *Lumber Exchange*, 968 F.2d 647; *Bryson Properties*, 961 F.2d 496; *John Hancock Mut. Life Ins. Co.*, 987 F.2d 154. All of these cases have held that it is improper to separately classify the deficiency claim of a secured creditor from

the general unsecured creditor class based upon the creditor's right to make an election pursuant to Section 1111(b)(2).

In *Boston Post Road*, the chapter 11 debtor sought confirmation of a plan of reorganization in which the debtor had separately classified the secured creditor's deficiency claim, as well as the claims of tenants for residential security deposits. The Second Circuit held that the unsecured claim of a secured creditor should have been placed in the same class with the other general unsecured creditors and that the residential security deposits were not impaired within the meaning of Section 1124(1). *Boston Post Road*, 21 F.3d at 479. Specifically, the Court held that:

> "The other circuits have generally held that separate classification of similar claims is permissible only upon proof of a legitimate reason for separate classification, and that separate classification to gerrymander an affirmative vote is impermissible."

Boston Post Road, 21 F.3d at 481, citing to *Greystone III*, 995 F.2d at 1279.

The Court further held that:

> "Separate classification of unsecured claims solely to create an impaired assenting class will not be permitted; the debtor must adduce credible proof of a legitimate reason for separate classification of similar claims."

Boston Post Road, 21 F.3d at 483.

The Second and Fifth Circuit decisions in *Boston Post Road* and *Greystone III* are based upon the legislative history of Sections 1111(b) and 1122.

> "Moreover, a reading of Section 1122 in the context of the rest of the Code suggests that discretionary separate classification of similar claims would undermine the Section 1111(b) election. As explained above, Section 1111(b) of the Bankruptcy Code permits an undersecured creditor to choose whether (i) its claim should be divided into a secured claim equal to the court-determined value of the collateral and an unsecured claim for the deficiency, or (ii) its entire claim should be considered secured. **The purpose of the Section 1111(b) election is to allow the undersecured creditor to weigh in its vote with the votes of the other unsecured creditors. Allowing the unsecured trade creditors to constitute their own class would effectively nullify the option that Congress provided to undersecured creditors to vote their deficiency as unsecured debt."**

Boston Post Road, 21 F.3d at 483 [emphasis added].

The Eighth Circuit has also held that it is improper to separately classify the deficiency claim of an unsecured creditor.

> " . . . [S]eparate classification of [the creditor's deficiency] claim eliminates a significant benefit of electing recourse status under 11 U.S.C. § 1111(b) – [the creditor's] opportunity to vote for or against confirmation as a member of the class of unsecured creditors."

Lumber Exchange, 968 F.2d at 649-50, citing to *Greystone III*, 948 F.2d at 140.

Barakat's Petition should be denied in light of the strong majority rule propounded by five of the six circuits which have ruled on the issue. The Seventh Circuit's decision in *Woodbrook* is an anomaly and is not a basis for granting the Petition in this case.

F. The Majority Position Is Supported by Sound Policy

The decisions of the Second, Third, Fifth, Eighth, and Ninth Circuits have created a flexible judicial rule which allows for separate classification of a deficiency claim when a court finds there is a legitimate independent business or economic justification for such separate classification. Barakat argues that these cases create a rigid rule that one may never separately classify a deficiency claim, thereby "creating bad law" in operating cases that should be legally confirmable. That is simply not true.

As discussed herein, these cases afford courts the flexibility to determine whether there is a legitimate and independent justification for separate classification beyond the need to gerrymander the classes to obtain a consenting impaired class, as there often is in legitimate operating cases. Barakat contends that there are other options such as the arguments that one could make upon confirmation hearing, motions to appoint a trustee, or other kinds of extraordinary relief. These remedies do not provide any solution to the problem created by debtors' gerrymandering of classes.

The reality is that in single-asset real estate bankruptcy cases, the secured creditor is frequently the one holding the largest claim. In this case LICV holds most of

the debt by a vast majority, even if one were to compare LICV's claim to the unsecured debt plus the value of the equity shareholders. There is nothing inappropriate about LICV having a significant voice in the outcome of a reorganization in order to make it meaningful. The goal of bankruptcy is to benefit not just Barakat, but his creditors. The extreme position taken by Barakat would preclude the bankruptcy court from ever having the ability to exercise discretion to protect a claimant's interests, as Congress intended and as the Bankruptcy Code provides.

In the case at hand, Barakat *never* offered *any* evidence of an independent justification for separate classification of LICV's deficiency claim. Barakat's separate classification of LICV's deficiency claim was improper due to the lack of a legitimate independent business or economic justification pursuant to the binding law of *Tucson Self-Storage*, 166 B.R. 892. Accordingly, the bankruptcy court correctly held that Barakat's plan impermissibly classified LICV's deficiency claim.

G. Other Lower Court Decisions Follow Majority Rule

Lower courts in the Ninth Circuit and other circuits have recently followed the decisions of the Second, Third, Fifth, and Eighth Circuits, thus demonstrating the general consensus that it is not permissible to separately classify a deficiency claim without an independent justification. The bankruptcy court recently emphasized that most courts attempt to find an independent justification for separate classification other than the need for an impaired consenting class.

> "Most courts have looked to see if there is some business or economic reason independent of the debtor's need to separately classify the deficiency claim in order to confirm its plan."

See In re Baldwin Park Towne Center, Inc., 171 B.R. 375, 376 (Bankr. C.D. Cal. 1994), citing to *Boston Post Road*, 21 F.3d at 483; *In re Johnston*, 21 F.3d 323, 328 (9th Cir. 1994); *Tucson Self-Storage*, 166 B.R. at 898; and *In re Moorpark*, 161 B.R. 254, 257 (Bankr. C.D. Cal. 1993).

The district court in New York denied confirmation of a plan and granted relief from the automatic stay based upon the debtor's separate classification of the secured creditor's unsecured claim in order to prevent the secured creditor from dominating the general unsecured class. The district court upheld the bankruptcy court's decision and found that confirmation was not possible due to the improper gerrymandering of the classes. *In re One Times Square Associates, Ltd. Partnership*, 165 B.R. 773 (Bankr. S.D.N.Y. 1994).

The court in *One Times Square* specifically recognized that there was no rational basis for separately classifying the unsecured claim of the secured creditor.

> "The bankruptcy court's conclusion that the Plan could not be confirmed under the cram-down provisions rested primarily on its finding that the Debtor's proposed classification scheme was an impermissible attempt to manipulate the vote." *One Times Square*, 165 B.R. at 775.

See also In re North Washington Center Ltd. Partnership, 165 B.R. 805 (Bankr. D. Md. 1994) (held that it was impermissible to separately classify the trade creditors from the unsecured claim of the secured creditor); *In re Cantonwood*

Assoc. Ltd. Partnership, 138 B.R. 648 (Bankr. D. Mass. 1992) (holding that bankruptcy court has eliminated legal distinction between nonrecourse deficiency claims and other secured claims); *In re 266 Washington Associates*, 141 B.R. 275 (Bankr. E.D.N.Y. 1992) (courts concluded that the Section 1111(b) artificial deficiency claim of an undersecured creditor could not be separately classified).

H. Recent Bankruptcy Code Amendments Resolve the Issues

The Bankruptcy Reform Act of 1994 ("Reform Act") resolved the issues in this appeal and thus Barakat's Petition should be denied simply on this basis alone. The Reform Act deleted Section 1124(3) of the Bankruptcy Code, thus modifying the definition of "impairment." The primary issue in this case is whether a mortgage deficiency claim can be separately classified from other unsecured creditors so that a debtor may more easily obtain one impaired consenting class of creditors as required for plan confirmation pursuant to Section 1129(a)(10). Under the Reform Act a debtor may now obtain an impaired consenting class of administrative convenience claims, and thus need not separately classify a mortgage deficiency claim in order to obtain the one impaired consenting class needed to confirm a plan of reorganization.

1. The Amendment to Section 1124

Before the Reform Act, Section 1124 provided as follows:

"Except as provided in section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan –

(1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest; or

(2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default –

(A) cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365(b)(2) of this title;

(B) reinstates the maturity of such claim or interest as such maturity existed before such default;

(C) compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law; and

(D) does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest; or

(3) provides that, on the effective date of the plan, the holder of such claim or interest receives, on account of such claim or interest, cash equal to –

> **(A) with respect to a claim, the allowed amount of such claim . . . "** [Emphasis added.]

2. The Amended Code Allows the Easy Creation of an Impaired Consenting Class

The Reform Act eradicated Section 1124(3) which deleted from the definition of "impaired" any creditor who was paid in full.[2] A debtor may use Section 1124 in conjunction with Section 1122(b) to create a class of administrative convenience claims which will be paid in full. As a result, a debtor may now, for example, separately classify administrative convenience claims in a separate class and provide for their full payment. Such a class is now "impaired" pursuant to Section 1124, and would consent to a plan which provides for their full payment. Thus a debtor could easily obtain the "impaired consenting class" requirement pursuant to Section 1129(a)(10) and would no longer need to classify a mortgage deficiency claim separately from the other general unsecured creditors.

I. Granting Certiorari Would Result in Unreasonable Delay to LICV

LICV will suffer substantial actual harm if the Petition is granted because the underlying property may be

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[2] The Bankruptcy Reform Act applies to cases filed after October 22, 1994. Barakat's case was filed before that date and thus the amendments do not apply to his case.

tied up for at least an additional one to two years. Obviously, the loss of use of the property in LICV's lending business for an extended period of time represents a substantial hardship to LICV. LICV will lose the opportunity to recapture its investment and may suffer a loss of its investment should the property continue to decline in value. LICV has already lost the opportunity costs of its investment while the property has been tied up in the pending appeal. Accordingly, LICV would be substantially harmed by the granting of the Petition and thus Barakat's request should be denied.

Moreover, the granting of the Petition in this case would also prevent LICV from exercising its rights pursuant to loan documents to which Barakat agreed. The stay in effect during the appeals process chills future investment incentives to lending institutions similar to LICV. As set forth above, Barakat filed the Petition as a delay and leverage tactic and, therefore, Barakat's Petition must be denied.

III. CONCLUSION

The Second, Third, Fifth, Eighth, and now Ninth Circuit decisions and their progeny are all squarely on point with the case at hand. The bankruptcy court found that Barakat separately classified the undersecured portion of LICV's claim from the general unsecured class without *any* rational basis or legitimate business or economic justification. By separately classifying LICV's claim, Barakat hoped to create an impaired class which would vote to accept its plan of reorganization. If LICV's claim had not been separately classified, LICV would

have dominated the unsecured class, and Barakat would not have had a consenting impaired class as required by Sections 1129(a)(10) and 1129(b). Barakat's separate classification of LICV's unsecured claim is impermissible, and thus the bankruptcy court properly granted LICV's motion for relief from the automatic stay.

The Seventh Circuit Court of Appeals decision in *Woodbrook* is an aberrational decision. The Seventh Circuit concluded that it was permissible to separately classify an unsecured deficiency claim which arises by operation of Section 1111(b) from other general unsecured claims. That Court determined that separate treatment is allowed solely on the distinction that the claim is created by operation of law.

The Second, Third, Fifth, Eighth and Ninth Circuits have held that such a distinction, without more, is insufficient to justify separate classification. All of the circuits are consistent that special circumstances must exist for separate classification. The Seventh Circuit merely found that a deficiency claim created by law supplies such a justification. However, this distinction alone does not present a substantial federal question that must be resolved to create national uniformity.

The argument that this case will have any kind of significant effect on chapter 11 cases generally is unsound. Many economic and business justifications exist which would facilitate confirmation of a debtor's plan in most situations. Barakat never even articulated a reason for the separate classification of the deficiency claim. This case is confined to its facts and is extremely unlikely to

reoccur. Thus no significant issues of federal law exists. In addition, the Reform Act now allows debtors to easily create an impaired consenting class, thus alleviating the need for separate classification of a mortgage deficiency claim.

For the foregoing reasons, Barakat's Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Petitioner MOHAMMAD SAMIH BARAKAT ("Barakat") hereby replies to the "Brief in Opposition to Petition for Writ of Certiorari" ("Opposition") filed by Respondent THE LIFE INSURANCE COMPANY OF VIRGINIA ("LICV").

I. LICV'S RE-STATEMENTS OF THE QUESTIONS PRESENTED AND STATEMENT OF THE CASE ARE INACCURATE AND INCOMPLETE.

LICV's re-statement of the questions presented (Opposition, pg. i) is markedly incomplete for three reasons.

First, there is Circuit-level disagreement about the threshold question of whether a deficiency claim is "substantially similar" to other unsecured claims, and *can* be classified with such claims under 11 U.S.C. §1122(a).[1] In the Seventh Circuit, under *Matter of Woodbrook Assocs.*, 19 F.3d 312 (7th Cir. 1994), the issue presented by LICV would never be reached.

Second, numerous lower courts have held,[2] and scores of commentators have opined,[3] that even if a deficiency claim *could* be classified with general unsecured claims, there is no Code *requirement* compelling such classification. Therefore, the second question stated by Barakat – whether the Code requires that all similar claims be classified together absent some business justification – is another threshold question.

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[1] All statutory references herein are to the Bankruptcy Code (Title 11, United States Code) ("the Code").

[2] See, e.g., *In re ZRM-Oklahoma Partnership,* 156 B.R. 67 (Bankr. W.D. Ok. 1991); *In re SM 104, Ltd.*, 160 B.R. 202 (Bankr. S.D. Fla. 1993); *In re Rivers End Apartments, Ltd.*, 167 B.R. 470 (Bankr. S.D. Oh. 1994). Also see, *In re Baldwin Park Towne Center, Ltd.*, 171 B.R. 374 (Bankr. C.D. Cal. 1994) and the Bankruptcy Court Opinion below (Appendix, pages A-61, 65-66) reported at 173 B.R. 672 (Bankr. C.D. Cal. 1994).

[3] See articles cited in Petition, pgs. 22-23, n. 2.

Finally, even in jurisdictions which require the showing of an independent business or economic justification for separate classification of deficiency claims, substantial disagreement exists about what constitutes such justification. There is no dispute that all six factors which justified separate classification in *Baldwin Park,* 171 B.R. at 377 were (and are) present in this case.[4] Courts continue to grapple with the difficulties of enforcing ill-defined standards for "business or economic justification" for separate classification.

Accordingly, LICV's re-statement of the questions presented by the Petition is misleading. The "Questions Presented" by Barakat in the Petition (pg. 1) are accurate.

LICV's addition to Barakat's "Statement of the Case" is also misleading. While it is true that the Bankruptcy Court found no justification for separate classification, it is equally true that all six *Baldwin Park* factors were present here.

II. THE PETITION PRESENTS A CIRCUIT-LEVEL DISAGREEMENT ON A SIGNIFICANT ISSUE OF FEDERAL LAW.

LICV asserts that "the Petition does not present a significant issue of federal law, but rather only Barakat's failure to meet the factual requirements of the applicable standard of law." (Opposition, pg. 2). This is plainly not so. Whether Barakat failed to meet factual requirements of "the applicable standard of law" cannot be answered until this Court resolves the conflict among the Circuits (and lower courts and commentators) on the applicable standard of law.

In its decision here, the Ninth Circuit joined the majority of Circuits, led by the Fifth Circuit in *In re Greystone III Joint Venture,* 995 F.2d 1274 (5th Cir. 1991), in holding that it is impermissible to separately classify a §1111(b) deficiency claim without an independent justification. As the Bankruptcy Court below noted, the Ninth Circuit's decision is "diametrically opposed" to that of the Seventh Circuit in

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[4] The *Baldwin Park* factors, and their undisputed presence in this case, are described in the Petition at pgs. 24-25.

Woodbrook, which held that such a claim *cannot* be classified with other unsecured claims. (Appendix, pg. A-65).

Further, the issue of federal law presented by this Petition is significant enough to have been referred to as a "hot topic" by the Bankruptcy Court below (Appendix, pg. A-65), and to have been the subject of scores of reported cases and hundreds of legal journal articles. (Petition, pgs. 21-23). Widespread litigation on this issue is driven not by mere academic interest but by the substantial economic impact of its consequences on deficiency claimholders (typically financial institutions), other unsecured creditors (typically small, locally-based businesses), and individual and small partnership debtors and their employees.

III. REGARDLESS OF WHETHER IT IS THE SEVENTH CIRCUIT OR NINTH CIRCUIT WHICH HAS MISINTERPRETED THE BANKRUPTCY CODE, CERTIORARI IS APPROPRIATE.

The Ninth Circuit here decided that the Seventh Circuit misinterpreted the Code in *Woodbrook*. Barakat believes that the Ninth Circuit misinterprets the Code here, and that the Seventh Circuit is correct. For purposes of this Petition, however, this conflict need only be noted, not resolved. Certiorari is appropriate because, as LICV *admits*, the Ninth Circuit and Seventh Circuit decisions are in direct and irreconcilable conflict.

Moreover, as described below, none of the substantive bases on which LICV attacks *Woodbrook* withstand analysis.

A. Other Sections of the Bankruptcy Code Are Not Ignored or Rendered Meaningless by a "Plain Meaning" Reading of §1122(a).

LICV contends that the reading of the plain meaning of §1122(a) advocated by Barakat is incorrect, because it is an analysis "in a vacuum, ignoring other sections of the Bankruptcy Code" (Opposition, p. 4), citing *United Savings Ass'n v. Timbers of Inwood Forest,* 484 U.S. 365 (1988). However,

Timbers is inapposite, because §1122(a) clearly and unambiguously does *not* require that similar claims be classified together. Therefore, §1122(a) need not be "clarified by the remainder of the statutory scheme."

This Court has noted that the Code is the result of Congressional compromises concerning the competing interests of various parties in a bankruptcy case. *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 61 n. 12 (1982). This Court has found that the Code as a whole is coherent and consistent. Accordingly, this Court repeatedly looks to the plain meaning of individual provisions to interpret their meaning. *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 240-41 (1989); *Union Bank v. Wolas*, 502 U.S. 151 (1991). If a restriction is not present in the express language of a statute, this Court will not "create a distinction the words of the statute do not contain." *Owen v. Owen*, 500 U.S. 305, 313 (1991). See also, *Toibb v. Radloff*, 501 U.S. 157 (1991); *Patterson v. Shumate*, 504 U.S. 753 (1992).

However, even if it were proper for this Court to examine other statutes within the Code in interpreting §1122(a), the Ninth Circuit's conclusion here does not withstand analysis.

The Ninth Circuit endorsed the notion that §1122(b) would be rendered meaningless if §1122(a) allows a debtor to separately classify similar claims. (Appendix, pg. A-11; Opposition, pgs. 5-6). This contention overlooks the analysis set out in *ZRM-Oklahoma*, 156 B.R. at 70 (Petition, pgs. 18-19).

The Ninth Circuit also accepted *Greystone*'s proposition that "§1111(b)(2) would become meaningless if §1122(a) is interpreted to allow for the separate classification of a secured creditors' deficiency claim." (Opposition, pg. 6; Appendix, pg. A-14). Insistence on classifying §1111(b) claims with other claims leads to bizarre anomalies in the application of §1111(b). (Petition, pgs. 19-20).

Further, *Greystone*'s analysis of the §1111(b) election as a basis for reading into §1122(a) a requirement that all unsecured claims be grouped together does not withstand scrutiny. The Fifth Circuit started with the following notion: "Generally, the creditor may elect recourse status and obtain

the right to vote in ***the*** unsecured class, or it may elect to forego recourse to gain an allowed secured claim for the entire amount of the debt." 948 F.2d at 140 (emphasis added). In fact, §1111(b) does not address whether a creditor electing recourse status has a right to vote in any class, much less in "***the***" unsecured class, which assumes without analysis that there can (or should) be only one unsecured class.

The Circuit-level cases that follow *Greystone* are based on the same fallacy that §1111(b) implies a right to vote *with* (i.e., in the same class as) other unsecured creditors, not just a right to vote an unsecured claim. *In re Boston Post Rd. Ltd. Partnership,* 21 F.3d 477, 483 (2d Cir. 1994); *In re Lumber Exchange Bldg. Ltd.,* 968 F.2d 647, 649-50 (8th Cir. 1992).

B. The Bankruptcy Code Is Consistent with Allowing Separate Classification of Deficiency Claims.

Although the Ninth Circuit did not so hold, LICV argues, without case authority or other support, that allowance of separate classification pursuant to the plain meaning of §1122(a) would violate §§1129(a) and (b). LICV's argument is that by allowing separate classification, a debtor could separately classify every creditor, hoping to get at least one vote in favor of the plan, and thereby to obtain the accepting class required by §1129(a)(10).

The argument that allowing separate classification would lead to the proliferation of plans with all claims separately classified ignores plan proponents' reluctance to create multiple classes due to the leverage available to each dissenting class. Every dissenting class is protected separately by §1129(b). Every class has the right to contend that discrimination between it and the other classes is "unfair" and that the plan is not "fair and equitable." Every class is entitled to protection of the absolute priority rule. Underlying all of these protections is the fact that the burden of proof is on the proponent to show that the requirements of §1129(b) have been satisfied as to every class. *In re Arnold and Baker Farms,* 177 B.R. 648, 654 (Bankr. 9th Cir. 1994).

It is precisely because of these protections that allowing separate classification of claims does not result in the automatic confirmation of any given plan. See, *In re U.S. Truck Co., Inc.*, 800 F.2d 581, 587 (6th Cir. 1986); *Rivers End, supra*; *In re BMW Group I, Ltd.*, 168 B.R. 731 (W.D. Ok. 1994) (separate classification allowed; confirmation denied). The parade of horribles portrayed by LICV is sheer fantasy.

LICV argues that if §1122(a) allows separate classification, the §1126(c) definition of acceptance becomes irrelevant. This argument is frivolous. Many definitions in the Code are not relevant in any particular case. No one claims that §1122(a) mandates that every claim be classified separately; §1126(c) remains relevant in every case in which any class contains more than one claim, and would be relevant here under Barakat's proposed Plan as to the five multiple-member classes.

C. The Majority of Circuits Improperly Treat the Plan Proponent's Motivation as Relevant to the Propriety of Classification, and Exhibit an Improper Bias Against Single Asset Real Estate Debtors.

LICV's analysis of the majority rule on classification (Opposition, pgs. 8-11) is telling. The phrases "*legitimate* reason for separate classification," "*legitimate* operating cases," and the loaded pejorative "*gerrymandering*" highlight the majority's unwarranted bias against single asset real estate debtors.

The *Greystone* line of cases assumes, without authority or analysis, the relevance of a plan proponent's motivation in separately classifying a deficiency claim to enhance the likelihood of obtaining an impaired consenting class as required by §1129(a)(10). *In re Gato Realty Trust Corp.*, 183 B.R. 15, 23 (Bankr. D. Mass. 1995); *In re Bloomingdale Partners*, 170 B.R. 984, 995-96 (Bankr. N.D. Ill. 1994).

No court would say that it is manipulative or an abuse of the reorganization process for a plan to propose to pay creditors at least as much as they would receive under Chapter 7,

in a "blatant attempt" to comply with §1129(a)(7). Nor would any court criticize a proponent for proposing a plan that is not likely to be followed by liquidation, in a "transparent effort" to comply with §1129(a)(11), or one that continues retiree benefits just to achieve compliance with §1129(a)(13). Section 1129(a)(10) includes the only safeguard deemed necessary by Congress: acceptances by insiders do not count. This shows that §1129(a)(10) was intended not to give any interest a veto power, but merely to require some indicia of *non-insider* creditor support to proceed to a cramdown hearing. *Woodbrook,* 19 F.3d at 318; *SM 104,* 160 B.R. at 218.

Use of "gerrymandering" to describe separate classification of deficiency claims illustrates the results-oriented analysis of the *Greystone* cases. The right to vote in a Chapter 11 plan does not equal the right to control the plan process. *Rivers End,* 167 B.R. at 478. A better example of improper manipulation of the plan process can be found in the failure of a deficiency claimholder to exercise its §1111(b) election, not because it desires the treatment afforded to unsecured creditors, but because it knows that its claim will overwhelm the unsecured class and thereby torpedo the plan. *Gato Realty,* 183 B.R. at 23.

In "legitimate operating cases" (as distinguished from single asset real estate cases), courts have uniformly allowed separate classification of substantially similar unsecured claims on the basis of different economic motives of creditors. *Matter of Jersey City Medical Center,* 817 F.2d 1055, 1060-61 (3rd Cir. 1987); *U.S. Truck,* 800 F.2d at 587; *In re Chateaugay Corp.,* 155 B.R. 625, 632-35 (Bankr. S.D. N.Y. 1993), *aff'd,* 177 B.R. 176 (S.D. N.Y. 1995); *In re Richard Buick, Inc.,* 126 B.R. 840, 851-52 (Bankr. E.D. Pa. 1991); *Matter of Rochem, Ltd.,* 58 B.R. 641, 643 (Bankr. D. N.J. 1985).

There is nothing "illegitimate" about single asset real estate cases which allows the different restrictions imposed upon such debtors by the *Greystone* line of cases. In the Bankruptcy Reform Act of 1994, Congress imposed certain specific restrictions on single asset real estate debtors at new §362(d)(3). (Petition, pgs. 28-29). Congress did not indicate

that additional distinctions between "legitimate operating cases" and single asset real estate cases were warranted.

LICV asserts that the *Greystone* line of cases "have created a flexible judicial rule which allows for separate classification of a deficiency claim when a court finds there is a legitimate independent business or economic justification for separate classification." (Opposition, p. 11). The Ninth Circuit disagreed, noting that its rule "will effectively bar single asset debtors from utilizing the Bankruptcy Code's cramdown provisions." (Appendix, pg. A-14). As noted in *Baldwin Park*, 171 B.R. at 376, "[t]he problem is that the courts rarely find sufficient evidence to support" a plan proponent's assertion of such economic or business justification. Lower courts do not uniformly apply *Greystone*'s "one clear rule." For example, the result in this case cannot be squared with *Baldwin Park*, nor with *In re Elmwood,* 182 B.R. 845 (D. Nev. 1995) (which allowed separate classification based on differences in plan treatment), nor with *In re Johnston,* 21 F.3d 323 (9th Cir. 1994) (which held separate classification warranted because the claimant was situated differently from other unsecured creditors on a legal basis, just as a §1111(b) deficiency claimant is different from other unsecured creditors). In practice, this "flexible" standard is enforced inconsistently, haphazardly, and ultimately unfairly. Indeed, even if the Seventh Circuit had not bolted from the *Greystone* pack in *Woodbrook*, the inconsistent interpretation of the *Greystone* standard would justify a grant of certiorari here.

IV. THE DELETION OF §1124(3) DOES NOT RESOLVE THE ISSUES PRESENTED.

The elimination of former §1124(3) is of no significance in this case, and would likewise be of no significance in most cases affected by the issue here. LICV blithely asserts that Barakat could seek to meet §1129(a)(10) by creating an administrative convenience class pursuant to §1122(b). This argument overlooks that creation of such a class hinges on the court finding that creation of such a class is, as the statute

requires, "reasonable and necessary for administrative convenience." Unless there are enough small unsecured claims, the threshold determination that such a classification is "necessary for administrative convenience" will not be met. See, e.g., *In re S & W Enters.*, 37 B.R. 153, 162 (Bankr. N.D. Ill. 1984) (convenience class allowed only when not to have one would be burdensome or create complexity).

LICV's suggestion that §1129(a)(10) could be met by an artificially-created convenience class runs counter to *Greystone*-like authority. In *S & W*, the court found that creation of a convenience class was merely to satisfy §1129(a)(10); thus, the court rejected the classification scheme. See also, *In re North Washington Center Ltd. Partnership*, 165 B.R. 805, 809-810 (Bankr. D. Md. 1994). Moreover, the existence of some alternative theory on which Barakat could present a modified plan and proceed to confirmation does not eliminate the conflict among the Circuits on the classification issue actually and squarely presented in this case.

V. LICV WILL NOT BE HARMED BY ANY DELAY OCCASIONED BY GRANTING CERTIORARI.

LICV's contention that it "will suffer substantial actual harm if the Petition is granted" is incorrect. The Ninth Circuit granted Barakat's emergency motion to stay the mandate by Order entered December 30, 1996 (Appendix, pg. A-23). The Order incorporates the terms of the stay issued by the District Court (Appendix, pgs. A-32-35), including *inter alia* the requirement that Barakat pay LICV $27,500 per month, and maintain insurance and tax payments on the subject property. The $27,500 payments are based on an interest rate of 11% per annum, an enhancement of the note rate of 9.625% per annum.

Accordingly, LICV's interest is protected by the stay issued by the Ninth Circuit. If LICV believes that the terms of the stay are inadequate, LICV is free to seek modification of the stay. The fact that LICV will be prevented from foreclosing while this Court determines the issues on the merits is not a sufficient reason to deny certiorari.

VI. CONCLUSION

LICV contends that the Seventh Circuit decision in *Woodbrook* is "anomalous" or "aberrational." It is neither. Many courts and commentators have agreed with *Woodbrook*. But even if *Woodbrook* were anomalous, there remains a Circuit-level conflict on the exact issue presented here.

The claim that the classification issue presented here has little economic effect is wrong. In most single asset real estate cases, deficiency claimholders are financial institutions, while the other unsecured creditors tend to be small, locally-based suppliers and service people. *Greystone*'s grant of veto power to deficiency claimholders tilts the playing field sharply in favor of lender interests and against unsecured small business creditors, individual and small partnership debtors, and their employees. This shift in power does violence to the balance crafted by Congress in enacting the Code. If this issue were unique to Barakat and unlikely to reoccur, there would not be such a volume of contradictory case law and scholarly articles dealing with this issue. LICV's assertion that "many economic and business justifications exist which would facilitate confirmation of a debtor's plan in most situations" is not borne out by case law, which overwhelmingly finds no such justification in single asset real estate cases.

The Opposition fails to state a single cogent reason why exercise of this Court's certiorari jurisdiction would be inappropriate. Accordingly, this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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